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BBA [Banking]

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BUSINESS LAW

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SYLLABI-BOOK MAPPING TABLE

Business Law

Syllabi	Mapping in Book
BLOCK I: BASICS OF BUSINESS LAW **UNIT 1:** Introduction: Introduction, Meaning and Scope of Business Law, Sources of Law, Laws applicable to Business **UNIT 2:** Indian Contract Act, 1872: Introduction, Definition and Meaning of Contract, Essentials of a Contract, Types of Contracts, Capacity of Parties, Modes of Discharge of a Contract, Remedies for Breach of Contract. **UNIT 3:** Law of Agency: Introduction, Agent and Agency, Kinds of Agencies, Creation of Agency, Principal and Agent, Termination of Agency **UNIT 4:** Sale of Goods Act, 1930: Introduction, Contact of Sale of Goods, Essentials of a Contract of Sale, Price, Agreement to sell at valuation, Rights and Duties of Buyer, Right of Unpaid Seller, Conditions and Warranties, Transfer of Property, Performance of Contract	**Unit 1:** Introduction to Business Law **(Pages 1-5);** **Unit 2:** Indian Contract Act, 1872 **(Pages 6-40);** **Unit 3:** Law of Agency **(Pages 41-56);** **Unit 4:** Sale of Goods Act, 1930 **(Pages 57-104)**
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BLOCK III: IPR & IT **UNIT 9:** Competition Act, 2002: Meaning and Scope of Competition Act, Salient Features of Competition Act, Offences and Penalties under the Act **UNIT 10:** Intellectual Property Rights: Meaning and Scope of Patent Act and Amendments of WTO Agreements, Rights of Patentee , Infringement , Remedies, Trademarks, Copyright **UNIT 11:** Information Technology Act, 2000: Background, Salient Features, Digital Signature, Electronic Governance, Regulation of Certifying Authorities, Cyber Laws, Penalties for Offences.	**Unit 9:** Competition Act, 2002 **(Pages 232-240);** **Unit 10:** Intellectual Property Rights **(Pages 241-257);** **Unit 11:** Information Technology Act, 2000 **(Pages 258-284);**

BLOCK IV: MSME

UNIT 12: Micro Small And Medium Enterprises Development Act, 2006: Classification of Micro, Small and Medium Enterprises,

UNIT 13: Salient Features of Micro, Small and Medium Enterprises Act, - Reservation Policy, Credit Policy, Government Policy towards Taxation and Incentives -

UNIT 14: Management of companies -Meetings- Types- Requirements - Protection of minority interest- Methods of Winding-up.

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INTRODUCTION

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The term 'Business Law' may be defined as that branch of law which comprises laws concerning trade, industry and commerce. It is an ever growing branch of law with the changing circumstances of trade and commerce. With the increasing complexities of the modern business world, the scope of business regulations has enormously widened. It is generally understood to include the regulations relating to contracts, sale of goods, partnership, companies, negotiable instruments, insurance, insolvency, carriage of goods, and arbitration. It is indispensable for the people engaged in economic and commercial pursuits to acquaint themselves with the general principles of the basic business regulations.

Prior to the enactment of the various Acts constituting business regulations, business transactions were regulated by the personal laws of the parties to the suit.

The subject matter has been discussed in a simple and intelligible language, maintaining clarity and cohesion throughout the book, so that even a student without any background of law will be able to understand the otherwise difficult provisions of the various legislations covered. The book unfolds the intricate points of law in a lucid manner and seeks to answer tricky questions which might intrigue the mind of a curious reader.

This book, *Business Law* is divided into fourteen units that follow the self-instruction mode with each unit beginning with an Introduction to the unit, followed by an outline of the Objectives. The detailed content is then presented in a simple but structured manner interspersed with Check Your Progress Questions to test the student's understanding of the topic. A Summary along with a list of Key Words and a set of Self-Assessment Questions and Exercises is also provided at the end of each unit for recapitulation.

BLOCK - I
BASICS OF BUSINESS LAW

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UNIT 1 INTRODUCTION TO BUSINESS LAW

Structure

1.0 INTRODUCTION

In this unit, you will learn about business 'law'. You will be introduced to the definitions of law, as well as the sources of mercantile or business law and its scope and interpretation. You will learn that business law is an ever-growing branch of law in the ever-changing world of trade and commerce. In addition, you will also learn about the various laws related to business in India.

1.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the meaning of law
- Enumerate the definition and scope of business law
- Analyse the sources of business law
- Understand the interpretation of business law
- Enumerate the harmonious construction of various acts

1.2 BUSINESS LAW: AN OVERVIEW

According to the Oxford English Dictionary, the word 'law' means 'rule made by an authority for the proper regulation of a community or society or for correct

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conduct in life.' In the words of Woodrow Wilson, 'Law is that portion of the established habit and thought of mankind which has gained distinct and formal recognition in the shape of uniform rules backed by the authority and power of the Government.' Broadly speaking, the term 'law' denotes rules and principles either enforced by an authority or self-imposed by the members of a society to control and regulate people's behaviour with a view to securing justice, peaceful living and social security.

1.2.1 Meaning and Scope of Business Law

The term 'business law' may be defined as that branch of law which comprises laws concerning trade, industry and commerce. It is an ever growing branch of law with the changing circumstances of trade and commerce.

With the increasing complexities of the modern business world, the scope of mercantile law has enormously widened. It is generally understood to include the laws relating to contracts, sale of goods, partnership, companies, negotiable instruments, insurance, insolvency, carriage of goods, and arbitration.

1.2.2 Sources of Business Law

The main sources of Indian business law are as follows:

1. **English Mercantile Law:** The English mercantile law constitutes the foundation on which the super-structure of the Indian mercantile law has been built. Even now, despite the enactment of various statutes relating to matters falling within the purview of the mercantile law, our courts generally take recourse to the English Law where some principles are not expressly dealt within an Act, or where there is ambiguity.
2. **The Statute Law:** When a Bill is passed by the Parliament and signed by the President, it becomes an 'Act' or a 'statute'. The bulk of Indian mercantile law is statute law. The Indian Contract Act, 1872: The Negotiable Instruments Act, 1881; The Sale of Goods Act, 1930; The Indian Partnership, Act, 1932; The Companies Act, 1956 are instances of the statute law.
3. **Judicial decisions or Case Law:** Judicial decisions are usually referred to as precedents and are binding on all courts having jurisdiction lower to that of the court which gave the judgement. They are also generally followed even by those of equal jurisdiction in deciding similar points of law. Whenever an Act is silent on a point or there is ambiguity, the judge has to decide the case according to the principles of justice, equity and good conscience.
4. **Customs and usages:** Custom or usage of a particular trade also guides the courts in deciding disputes arising out of mercantile transactions, but such a custom or usage must be widely known, certain and reasonable, and must not be opposed to any legislative enactment. But where a statute specifically provides that the rules of law contained therein are subject to any well recognized custom or usage of trade, the latter may over-ride the statute law.

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1.2.3 Interpretation of Business Law: Laws Applicable to Business

The Indian Contract Act, 1872; The Negotiable Instruments Act, 1881; The Sale of Goods Act, 1930; The Indian Partnership Act, 1932 and The Companies Act, 1956 are instances of Statute Law in the field of 'business law'. These Acts may be interpreted according to the intention of the legislature. The reality, however, is that in certain cases courts and lawyers are busy in unfolding the meaning of ambiguous words and expressions and resolving inconsistencies. In such cases of doubt assistance is sought from foreign decisions, mostly English, because many Indian Acts are modelled on English Acts. Judicial decisions are usually referred to as precedents and are generally followed by the courts. If no precedents are found anywhere, the Courts will use their own judgement, perhaps on the basis of 'equity, justice and good conscience' or upon the basis of 'customs and traditions of the people'.

In the interpretation of an Act, the rule of harmonious construction should be followed. An Act must be read as a whole and any one provision of the Act should be construed with reference to other provisions in the same Act so as to make a consistent enactment of the whole statute. The provisions of one section of an Act cannot be used to defeat those of another; therefore Sections and Sub-sections of an Act must be read as part of an integral whole and as being interdependent.

Check Your Progress

1. What do you mean by business law?
2. List the main sources of Indian mercantile law.

1.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The term 'business law' may be defined as that branch of law which comprises laws concerning trade, industry and commerce. It is an ever growing branch of law with the changing circumstances of trade and commerce. With the increasing complexities of the modern business world, the scope of mercantile law has enormously widened
2. The main sources of Indian business law are as follows:
   (i) English Mercantile Law: The English mercantile law constitutes the foundation on which the super-structure of the Indian mercantile law has been built.
   (ii) The Statute Law: When a Bill is passed by the Parliament and signed by the President, it becomes an 'Act' or a 'statute'. The bulk of Indian mercantile law is statute law.
   (iii) Judicial decisions or Case Law: Judicial decisions are usually referred to as precedents and are binding on all courts having jurisdiction lower to that of the court which gave the judgement.

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(iv) Customs and usages: Custom or usage of a particular trade also guides the courts in deciding disputes arising out of mercantile transactions, but such a custom or usage must be widely known, certain and reasonable, and must not be opposed to any legislative enactment.

1.4 SUMMARY

- Broadly speaking, the term 'law' denotes rules and principles either enforced by an authority or self-imposed by the members of a society to control and regulate people's behaviour with a view to securing justice, peaceful living and social security.
- The term 'business law' may be defined as that branch of law which comprises laws concerning trade, industry and commerce. It is an ever growing branch of law with the changing circumstances of trade and commerce.
- The English mercantile law constitutes the foundation on which the super-structure of the Indian mercantile law has been built.
- When a Bill is passed by the Parliament and signed by the President, it becomes an 'Act' or a 'statute'. The bulk of Indian mercantile law is statute law.
- Custom or usage of a particular trade also guides the courts in deciding disputes arising out of mercantile transactions, but such a custom or usage must be widely known, certain and reasonable, and must not be opposed to any legislative enactment.
- The Indian Contract Act, 1872; The Negotiable Instruments Act, 1881; The Sale of Goods Act, 1930; The Indian Partnership Act, 1932 and The Companies Act, 1956 are instances of Statute Law in the field of 'business law'.
- Judicial decisions are usually referred to as precedents and are generally followed by the courts. If no precedents are found anywhere, the Courts will use their own judgement, perhaps on the basis of 'equity, justice and good conscience' or upon the basis of 'customs and traditions of the people'.
- The provisions of one section of an Act cannot be used to defeat those of another; therefore Sections and Sub-sections of an Act must be read as part of an integral whole and as being interdependent.

1.5 KEY WORDS

- **The Indian Contract Act, 1872**: It prescribes the law relating to contracts in India. The Act was passed by British India and is based on the principles of English Common Law.
- **The Companies Act, 1956**: It is an Act enacted in 1956 relating to companies and certain other associations.

1.6 SELF-ASSESSMENT QUESTIONS AND EXERCISES

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Short-Answer Questions

1. Write a short note on the term 'law'.
2. Write a brief about the scope of business law.
3. Write a short note on the statute law
4. Write in brief about interpretation of business law in India.

Long-Answer Questions

1. "Business law is an ever growing branch of law." Justify this statement.
2. Discuss the main sources of business law.
3. Analyse the contribution of the English Acts in India's business law.

1.7 FURTHER READINGS

Kuchhal, M.C. and Vivek Kuchhal. 2013. *Business Law,* sixth edition. Delhi: Vikas Publishing House.

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Pillai, R. S.N. and V. Bhagavathy. 2009. *Business Law*. New Delhi: Sultan Chand Co & Ltd.

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UNIT 2 INDIAN CONTRACT ACT, 1872

Structure

2.0 INTRODUCTION

The law of contract is the foundation upon which the superstructure of modern business is built. This unit will introduce you to the Indian Contract Act, 1872. You will learn about contract, its definition, kinds and characteristics. As you progress, you will learn about valid factors that contribute to make a party competent. An essential element of a contract is that the parties must be competent to enter into a contract.

2.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand contract, know its essential features, and identify its types
- Learn about offers and acceptance

- Understand the meaning and essentials of consideration
- Analyse competence of parties
- Understand the meaning of breach of contract

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2.2 DEFINITION AND MEANING OF CONTRACT

The law of contract in India is contained in the Indian Contract Act, 1872. It extends to the whole of India except the state of Jammu and Kashmir and came into force on 1 September 1872. The Act is not exhaustive. It does not deal with all the branches of the law of contract. There are separate Acts that deal with contracts relating to negotiable instruments, transfer of property, sale of goods, partnership, insurance, etc. Again, the Act does not affect any usage or custom of trade (Sec. 1). A minor amendment in Section 28 of the Act was made by the Indian Contract (Amendment) Act, 1996.

According to Section 2 (h) of the Indian Contract Act: 'An agreement enforceable by law is a contract.' A contract, therefore, is an agreement the object of which is to create a legal obligation, i.e., a duty enforceable by law.

From the above definition, we find that a contract essentially consists of two elements: (1) An agreement, and (2) Legal obligation, i.e., a duty enforceable by law. We shall now examine these elements in detail. These are as follows:

1. **Agreement:** As per Section 2(e), 'Every promise and every set of promises, forming the consideration for each other, is an agreement.' Thus it is clear from this definition that a '**promise**' is an agreement. What is a 'promise'? The answer to this question is contained in Section 2(b) which defines the term: 'When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise.' An agreement, therefore, comes into existence only when one party makes a proposal or offer to the other party and that other party signifies his assent (i.e., gives his acceptance) thereto. In short, an agreement is the sum total of 'offer' and 'acceptance'.
2. **Legal obligation:** As stated above, an agreement to become a contract must give rise to a legal obligation, i.e., a duty enforceable by law. If an agreement is incapable of creating a duty enforceable by law, it is not a contract. Thus an agreement is a wider term than a contract. 'All contracts are agreements but all agreements are not contracts.' Agreements of moral, religious or social nature, such as a promise to lunch together at a friend's house or to take a walk together are not contracts because they are not likely to create a duty enforceable by law for the simple reason that the parties never intended that they should be attended by legal consequences.

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In business agreements, the presumption is usually that the parties intend to create legal relations. Thus, an agreement to buy certain specific goods at an agreed price *e.g.*, 100 bags of wheat at ₹ 430 per bag is a contract because it gives rise to a duty enforceable by law, and in case of default on the part of either party, an action for breach of contract could be enforced through a court provided other essential elements of a valid contract as laid down in Section 10 are present, namely, if the contract was made by free consent of the parties competent to contract, for a lawful consideration and with a lawful object.

Thus, it may be concluded that the act restricts the use of the word 'contract' to only those agreements that give rise to legal obligations between the parties.

2.3 ESSENTIAL FEATURES OF A CONTRACT

A contract has been defined in Section 2(h) as 'an agreement enforceable by law'. To be enforceable by law, an agreement must possess the essential elements of a valid contract as contained in Sections 10, 29 and 56. According to Section 10, all agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration, with a lawful object, are not expressly declared by the Act to be void, and, where necessary, satisfy the requirements of any law as to writing or attestation or registration. We now will discuss the essential features of a contract in brief here.

The essential elements of a valid contract are as follows:

1. **Offer and acceptance:** There must be a 'lawful offer' and a 'lawful acceptance' of the offer, thus resulting in an agreement. The adjective 'lawful' implies that the offer and acceptance must satisfy the requirements of the Contract Act in relation thereto.
2. **Intention to create legal relations:** There must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. Agreements of a social or domestic nature do not contemplate legal relations, and as such they do not give rise to a contract. An agreement to dine at a friend's house is not an agreement intended to create legal relations and therefore is not a contract. Agreements between husband and wife also lack the intention to create legal relationship and thus do not result in contracts.

   These can be shown by the following illustrations**.** These are:

   (a) *M* promised his wife *N* to get her a saree if she would sing a song. *N* sang the song but *M* did not bring the saree for her. *N* could not bring an action in a Court to enforce the agreement as it lacked the intention to create legal relations.

   (b) The defendant was a civil servant stationed in Sri Lanka. He and his wife were enjoying leave in England. When the defendant was due to return to Sri Lanka, his wife could not accompany him because of her

health. The defendant agreed to send her £30 a month as maintenance expenses during the time they were forced to live apart. She sued for breach of this agreement. Her action was dismissed on the ground that no legal relations had been contemplated, and therefore there was no contract. (*Balfour vs Balfour*)

3. **Lawful consideration:** The third essential element of a valid contract is the presence of 'consideration'. Consideration has been defined as the price paid by one party for the promise of the other. An agreement is legally enforceable only when each of the parties to it gives something and gets something. The something given or obtained is the price for the promise and is called 'consideration'. Subject to certain exceptions, gratuitous promises are not enforceable at law.

   The 'consideration' may be an act (doing something) or forbearance (not doing something) or a promise to do or not to do something. It may be past, present or future.

4. **Capacity of parties:** The parties to an agreement must be competent to contract, otherwise it cannot be enforced by a court of law. In order to be competent to contract the parties must be of the age of majority and of sound mind and must not be disqualified from contracting by any law to which they are subject (Sec. 11).

5. **Free consent:** Free consent of all the parties to an agreement is another essential element of a valid contract. 'Consent' means that the parties must have agreed upon the same thing in the same sense (Sec. 13). There is absence of 'free consent' if the agreement is induced by: (i) coercion, (ii) undue influence, (iii) fraud, (iv) misrepresentation, or (v) mistake (Sec. 14).

6. **Lawful object:** For the formation of a valid contract, it is also necessary that the parties to an agreement must agree for a lawful object. The object for which the agreement has been entered into must not be fraudulent or illegal or immoral or opposed to public policy or must not imply injury to the person or property of another (Sec. 23). If the object is unlawful for one or the other of the reasons mentioned above the agreement is void. Thus, when a landlord knowingly lets a house to a prostitute to carry on prostitution, he cannot recover the rent through a court of law.

7. **Writing and registration:** According to the Indian Contract Act, a contract may be oral or in writing. But in certain special cases it lays down that the agreement, to be valid, must be in writing or/and registered. For example, it requires that an agreement to pay a time barred debt must be in writing and an agreement to make an out of natural love and affection must be in writing and registered (Sec. 25). Similarly, certain other Acts also require writing or/and registration to make the agreement enforceable by law which must be observed. Thus, (i) an arbitration agreement must be in writing as per the Arbitration and Conciliation Act, 1996; (ii) an agreement for a sale of

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immovable property must be in writing and registered under the Transfer of Property Act, 1882, before they can be legally enforced.

8. **Certainty:** Section 29 of the Contract Act provides that 'Agreements, the meaning of which is not certain or capable of being made certain, are void'. In order to give rise to a valid contract, the terms of the agreement must not be vague or uncertain. It must be possible to ascertain the meaning of the agreement, for otherwise, it cannot be enforced.

   Illustration: *A* agrees to sell *B* 'a hundred tons of oil'. There is nothing whatever to show what kind of oil was intended. The agreement is void for uncertainty.

9. **Possibility of performance:** Yet another essential feature of a valid contract is that it must be capable of performance. Section 56 lays down that 'An agreement to do an act impossible in itself is void'. If the act is impossible in itself, physically or legally, the agreement cannot be enforced at law.

   Illustration. *A* agrees with *B* to discover treasure by magic. The agreement is not enforceable.

10. **Not expressly declared void:** The agreement must not have been expressly declared to be void under the Act. Sections 24–30 specify certain types of agreements which have been expressly declared to be void. For example, an agreement in restraint of marriage, an agreement in restraint of trade, and an agreement by way of wager have been expressly declared void under Sections 26, 27 and 30 respectively.

Before dealing with the various essentials of a valid contract one by one in detail, it will be appropriate to discuss the 'kinds of contracts', first, because we shall be using the terms like 'voidable contract', 'void contract', 'void agreement', *etc.*, very often in the course of our discussion.

2.4 TYPES OF CONTRACT

Let us discuss the various types of contracts.

A. Types of Contracts on the basis of Enforceability

On the basis of enforceability, a contract may be *valid* or *voidable* or *void* or *unenforceable* or *illegal*.

1. **Valid contract:** A valid contract is an agreement enforceable by law. An agreement becomes enforceable by law when all the essential elements of a valid contract are present.
2. **Voidable contract:** According to Section 2(i), 'an agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract'. Thus, a voidable contract is one which is enforceable by law at the option of one of

the parties. Until it is avoided or rescinded by the party entitled to do so by exercising his option in that behalf, it is a valid contract.

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3. **Void contract:** Literally the word 'void' means 'not binding in law'. Accordingly the term 'void contract' implies a useless contract which has no legal effect at all. Such a contract is a nullity, as there has been no contract at all. Section 2(j) defines: 'A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable.' It follows from the definition that a void contract is not void from its inception and that it is valid and binding on the parties when originally entered into but subsequently it becomes invalid and destitute of legal effect because of certain reasons.
4. **Unenforceable contract:** An unenforceable contract is one which is valid in itself, but is not capable of being enforced in a court of law because of some technical defect such as absence of writing, registration, requisite stamp, etc., or time barred by the law of limitation. For example, an oral arbitration agreement is unenforceable because the law requires an arbitration agreement to be in writing.
5. **Illegal or unlawful contract:** The word 'illegal' means 'contrary to law' and the term 'contract' means 'an agreement enforceable by law.' As such, to speak of an 'illegal contract' involves a contradiction in terms, because it means something like this—an agreement enforceable by law and contrary to law. There is an apparent contradiction in terms. Moreover, being of unlawful nature, such an agreement can never attain the status of a contract. Thus, it will be proper if we use the term 'illegal agreement' in place of 'illegal contract'. An illegal agreement is void *ab-initio*.

B. Types of Contracts on the basis of Mode of Creation

Contracts, on the basis of mode of creation, may be *express* or *implied* or *constructive*.

1. **Express contract:** When both the offer and the acceptance constituting an agreement are enforceable by law are made in words spoken or written, it is an express contract. For example, when *A* tells *B* on telephone that he offers to sell his car for ' 20,000 and *B* in reply informs *A* that he accepts the offer, there is an express contract.
2. **Implied contract**: Where both the offer and acceptance constituting an agreement enforceable by law are made other than in words, i.e., by acts and conduct of the parties, it is an implied contract. Thus, where *A*, a coolie in uniform, takes the luggage of *B* to be carried out of the railway station without being asked by *B*, and *B* allows him to do so; then the law implies that *B* agrees to pay for the services of *A*, and this is an implied contract.
3. **Constructive or quasi-contract**: The term 'constructive or quasi-contract' is a misnomer. The cases grouped under this type of contracts have little or no affinity with a contract. Such a contract does not arise by virtue of any

agreement, express or implied, between the parties but the law infers or recognizes a contract under certain special circumstances. For example, the obligation of the finder of lost goods to return them to the rightful owner or liability of a person to whom money is paid by mistake to repay it cannot be said to arise out of a contract even in its remotest sense, as there is neither offer and acceptance nor consent, but these are covered under quasi contracts as per Sections 71 and 72. The Contract Act has rightly named such contracts as 'certain relations resembling those created by contract'.

A quasi-contract is based upon the equitable principle that a person shall not be allowed to retain unjust benefit at the expense of another. Sections 68–72 of the Contract Act describe the cases which are to be deemed 'quasi-contracts'.

C. Types of Contracts on the basis of the Extent of Execution

On the basis of the extent of execution a contract may be *executed* or *executory*.

1. **Executed contract:** A contract is said to be executed when both the parties to a contract have completely performed their share of obligations and nothing remains to be done by either party under the contract. For example, when a bookseller sells a book on cash payment it is an executed contract because both the parties have done what they were to do under the contract.
2. **Executory contract.** It is one in which both the obligations are outstanding, one one either party to the contract, either wholly or in part, at the time of the formation of the contract. In other words, a contract is said to be executory when either both the parties to a contract have still to perform their share of obligations in toto, or there remains something to be done under the contract on both sides.

2.5 CAPACITY OF PARTIES

Section 11 lays down that 'every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject'. Thus this Section declares that a person is incompetent to contract under the following circumstances:

1. If he is a minor, according to the law to which he is subject,
2. If he is of unsound mind, and
3. If he is disqualified from contracting by any law to which he is subject.

2.5.1 Minor

According to Section 3 of the Indian Majority Act 1875, as amended by the Majority (Amendment) Act, 1999, a person, domiciled in India, who is under 18 years of age is a minor. Accordingly every person who has completed the age of 18 years becomes a major.

2.5.2 Minor's Agreements

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The law regarding a minor's agreements may be summed up as under:

1. **An agreement by a minor is absolutely void and inoperative as against him:** The law acts as the guardian of minors and protects their rights, because their mental faculties are not mature—they do not possess the capacity to judge what is good and what is bad for them. Accordingly, where a minor is charged with obligations and the other contracting party seeks to enforce those obligations against minor, the agreement is deemed as *void ab-initio.* In the leading case of *Mohori Bibi vs Dharmo Das Ghosh*, a minor executed a mortgage for ` 20,000 and received ` 8,000 from the mortgagee. The mortgagee filed a suit for the recovery of his mortgage money and for sale of the property in case of default. The Privy Council held that an agreement by a minor was *absolutely void* as against him, and therefore the mortgagee could not recover the mortgage money nor could he have the minor's property sold under his mortgage.
2. **Beneficial agreements are valid contracts:** As observed earlier, the court protects the rights of minors. Accordingly, any agreement which is of some benefit to the minor and under which he is required to bear no obligation, is valid. In other words, a minor can be a beneficiary e.g., a payee, an endorsee or a promisee under a contract. Thus, money advanced by a minor can be recovered by him by a suit because he can take benefit under a contract.
3. **No ratification on attaining the age of majority:** Ratification means the subsequent adoption and acceptance of an act or agreement. A minor's agreement being a nullity and void *ab-initio* has no existence in the eye of law. It cannot be ratified by the minor on attaining the age of majority, for, an agreement void *ab-initio* cannot be made valid by subsequent ratification (*Mohendra vs Kailash*).
4. **The rule of estoppel does not apply to a minor:** The rule of estoppel does not apply to a minor, i.e., a minor is not estopped from pleading his infancy in order to avoid a contract, even if he has entered into an agreement by falsely representing that he was of full age (*Sadiq Ali Khan vs Jai Kishore*).

   Thus, if a minor obtains a loan by fraudulent representation and purchases a motor car out of that, although the loan transaction is invalid, the court may direct the minor to restore the motorcar to the lender. But once the identity of the property or money has been lost because it has been spent wastefully, it is no longer possible to invoke the aid of the 'equitable doctrine of restitution'.
5. **Minor's liability for necessaries:** The case of necessaries supplied to a minor is governed by Section 68 of the Contract Act which provides that 'if a person, incapable of entering into a contract, or any one whom he is

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legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person'.

6. **Specific performance:** Specific performance means the actual carrying out of the contract as agreed. Since an agreement by a minor is absolutely void, the court will never direct 'specific performance' of such an agreement by him. But a contract entered into, on behalf of a minor, by his guardian or by the manager of his estate, is binding on the minor and can be specifically enforced by or against the minor, provided: (*a*) the contract is within the authority of the guardian or manager; and (*b*) it is for the benefit of the minor.
7. **Minor partner:** A minor being incompetent to contract cannot be a partner in a partnership firm, but under Section 30 of the Indian Partnership Act, he can be admitted to the 'benefits of partnership' with the consent of all the partners by an agreement executed through his lawful guardian with the other partners. Such a minor will have a right to such share of the property or profits of the firm as may be agreed upon and he would have access to and inspect and copy any of the accounts of the firm.
8. **Minor agent:** A minor can be an agent (Sec. 184). He shall bind the principal by his acts done in the course of such an agency, but he cannot be held personally liable for negligence or breach of duty. Thus in appointing a minor as an agent, the principal runs a great risk.
9. **Minor and insolvency:** A minor cannot be adjudicated an insolvent, for he is incapable of contracting debts. Even for necessaries supplied to him, he is not personally liable, only his property is liable (Sec. 68).
10. **Contract by a minor and adult jointly:** Where a minor and an adult jointly enter into an agreement with another person, the minor has no liability but the contract as a whole can be enforced against the adult (*Jamna Bai vs Vasanta Rao*). In *Sain Das vs Ram Chand*, where there was a joint purchase by two vendees, one of whom was a minor, it was held that the vendor could enforce the contract against the major vendee.
11. **Surety for a minor:** Where in a contract of guarantee an adult stands surety for a minor, the adult is liable under the contract, although the minor is not (as for there is a direct contract between the surety and the third party) (*Kashiba vs Shripat*). In fact, in such a case there cannot be a contract of guarantee in the true sense.
12. **Position of a minor's parents:** The parents of a minor are not liable for agreements made by a minor, whether the agreement is for the purchase of necessaries or not. The parents can be held liable only when the child is contracting as an agent for the parents.

13. **Minor shareholder:** A minor, being incompetent to contract, cannot be a shareholder of a company. A company can also refuse to register transfer or transmission of shares in favour of a minor unless the shares are fully paid. It follows from it that a minor, acting through his lawful guardian, may become a shareholder of the company in case of transfer or transmission of fully paid shares to him. Logically also, if a minor could legally hold property in his name, it would be wrong to debar him from holding fully paid up shares in his own name.
14. **Minor's liability in tort:** A 'tort' is a civil wrong (not having its genesis in contractual or equitable relationship) for which the ordinary remedy is damages. A minor is liable for his tort, unless the tort is in reality a breach of contract. Thus, where a minor hired a horse for riding and injured it by over-riding, he was not held liable (*Jennings vs Rundall*).

2.5.3 Persons of Unsound Mind

As stated earlier, as per Section 11 of the Contract Act, for a valid contract it is necessary that each party to it must be of 'sound mind'.

What is a 'sound mind'? Section 12 of the Contract Act defines the term 'sound mind' as follows: 'A person is said to be of sound mind for the purpose of making a contract, if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effects upon his interests.'

According to this Section, therefore, the person entering into the contract must be a person who understands what he is doing and is able to form a rational judgment as to whether what he is about to do is to his interest or not. The Section further states that:

(i) 'A person who is usually of unsound mind, but occasionally, of sound mind, may make a contract when he is of sound mind.' Thus a patient in a lunatic asylum, who is at intervals of sound mind, may contract during those intervals.

(ii) 'A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.' Thus, a sane man, who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgment as to its effect on his interest, cannot enter a contract in such a state.

Effects of agreements made by persons of unsound mind: An agreement entered into by a person of unsound mind is treated on the same footing as that of minor's, and therefore an agreement by a person of unsound mind is absolutely void and inoperative as, against him but he can derive benefit under it (*Jugal Kishore vs Cheddu*). The property of a person of unsound mind is, however, always liable for necessaries supplied to him or to any one whom he is legally bound to support, under Section 68 of the Act.

2.5.4 Disqualified Persons

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The third type of incompetent persons, as per Section 11, are those who are 'disqualified from contracting by any law to which they are subject'. Those are:

(a) **Alien enemies:** An alien (citizen of a foreign country) living in India can enter into contracts with citizens of India during peace time only, and that too subject to any restrictions imposed by the Government in that respect. On the declaration of a war between his country and India, he becomes an alien enemy and cannot enter into contracts. 'Alien friend can contract but an alien enemy can't contract'. Contracts entered into before the declaration of the war stand suspended and cannot be performed during the course of war; of course, they can be revived after the war is over provided they have not already become time-barred.

(b) **Foreign sovereigns and ambassadors:** One has to be cautious while entering into contracts with foreign sovereigns and ambassadors, because though they can sue others to enforce the contracts entered upon with them, they cannot be sued without obtaining the prior sanction of the Central Government. Thus they are in a privileged position and are ordinarily considered incompetent to contract.

(c) **Convict:** A convict is one who is found guilty and is imprisoned. During the period of imprisonment, a convict is incompetent (*a*) to enter into contracts, and (*b*) to sue on contracts made before conviction. On the expiry of the sentence, he is at liberty to institute a suit and the Law of Limitation is held in abeyance during the period of his sentence.

(d) **Married women:** Married women are competent to enter into contracts with respect to their separate properties (*Stridhan*) provided they are major and are of sound mind. They cannot enter into contracts with respect to their husbands' properties. A married woman can, however, act as an agent of her husband and bind her husband's property for necessaries supplied to her, if he fails to provide her with these.

(e) **Insolvent:** An adjudged insolvent (before an 'order of discharge') is competent to enter into certain types of contracts, i.e., he can incur debts, purchase property or be an employee but he cannot sell his property which vests in the Official Receiver. Before 'discharge' he also suffers from certain disqualifications, e.g., he cannot be a magistrate or a director of a company or a member of local body, but he has the contractual capacity except with respect to his property. After the 'order of discharge,' he is just like an ordinary citizen.

(f) **Joint-stock company and corporation incorporated under a special Act**: A company/corporation is an artificial person created by law. It cannot enter into contracts outside the powers conferred upon it by its Memorandum of Association or by the provisions of its special Act, as the case may be.

Again, being an artificial person (and not a natural person) it cannot enter into contracts of a strictly personal nature, e.g., marriage.

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2.5.5 Free Consent

According to Section 10, 'free consent' of all the parties to an agreement is one of the essential elements of a valid contract.

'Consent' defined: Section 13 of the Contract Act defines the term 'consent' and lays down that 'two or more persons are said to consent when they agree upon the same thing in the same sense'. Thus, consent involves identity of minds or *consensus ad-idem i.e.*, agreeing upon the same thing in the same sense. If, for whatever reason, there is no *consensus ad-idem* among the contracting parties, there is no real consent and hence no valid contract.

'Free Consent' defined: Section 14 lays down that 'Consent is said to be free' when it is *not caused* by—

1. *Coercion*, as defined in Section 15, *or*
2. *Undue influence*, as defined in Section 16, *or*
3. *Misrepresentation*, as defined in Section 18, *or*
4. *Fraud*, as defined in Section 17, *or*
5. *Mistake*, subject to the provisions of Sections, 20, 21 and 22.'

When consent to an agreement is caused by coercion, undue influence, misrepresentation or fraud, there is 'no free consent' and the contract is voidable at the option of the party whose consent was so caused (Sections 19 and 19A). But when consent is caused by 'bilateral mistake' as to a matter of fact essential to the agreement, the agreement is void (Sec. 20). In such a case there is 'no consent' at all.

2.5.6 Coercion

Section 15 of the Contract Act defines 'coercion' as follows: 'Coercion is the committing or threatening to commit, any act forbidden by the Indian Penal Code, or the unlawful detaining or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.'

A. Threat to commit suicide: Neither '*suicide*' nor '*threat to commit suicide*' is punishable under the Indian Penal Code; only '*an attempt to commit suicide*' is punishable under it. In *Chikkam Ammiraju vs Chikkam Seshamma*, there arose a question as to whether '*a threat to commit suicide*' amounts to coercion, and their Lordships of the Madras High Court answered the question in the affirmative holding that this amounts to coercion. In that case a person, by a threat to commit suicide, induced his wife and son to execute a release deed in favour of his brother in respect of certain properties which they claimed as their own. The transaction was set aside

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on the grounds of coercion. It was stated by the majority of judges that though 'a threat to commit suicide' was not punishable under the Indian Penal Code, it must be deemed to be *forbidden* by that Code, as 'an attempt to commit suicide' was punishable under Section 309 of that Code. Their Lordships observed: 'The term 'any act *forbidden* by the Indian Penal Code' is wider than the term '*punishable* by the Indian Penal Code.' Simply because a man escapes punishment, it does not follow that the act is not forbidden by the Penal code. For example, a lunatic or a minor may not be punished. This does not show that their criminal acts are not forbidden by the Penal Code.'

B. Effect of Coercion: A contract brought about by coercion is *voidable* at the option of the party whose consent was so caused (Sec. 19). This means that the aggrieved party may either exercise the option to affirm the transaction and hold the other party bound by it, or repudiate the transaction by exercising a right of rescission. As per Section 64, if the aggrieved party opts to rescind a voidable contract, he must restore any benefit received by him under the contract to the other party from whom received.

The burden of proof that coercion was used lies on the party who wants to set aside the contract on the plea of coercion.

2.5.7 Undue Influence

A. Definition of undue influence

Section 16(1) defines the term 'undue influence' as follows:

'A contract is said to be induced by undue influence where, (i) the relations subsisting between the parties are such that one of the parties is *in a position to dominate the will of the other*, and (ii) he uses the position to obtain an unfair advantage over the other.'

The phrase 'in a position to dominate the will of the other' is clarified by the same Section under subsection (2), thus:

Section 16(2). A person is deemed to be in a position to dominate the will of another—

(a) Where he holds a real or apparent authority over the other, e.g., the relationship between master and the servant, police officer and the accused; or

(b) Where he stands in a fiduciary relation to the other. Fiduciary relation means a relation of mutual trust and confidence. Such a relationship is supposed to exist in the following cases: father and son, guardian and ward, solicitor and client, doctor and patient, Guru (spiritual adviser) and disciple, trustee and beneficiary, etc.; or

(c) Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness, or mental or bodily distress, e.g., old illiterate persons.

It is to be observed that for proving the use of undue-influence, both the elements mentioned above, namely, (i) the other party was in a position to dominate his will, and (ii) the transaction was an unfair one, must be established.

B. Presumption of Undue Influence

Undue influence is presumed to exist under the circumstances mentioned above in sub-clauses (a), (b) and (c). In other words, for example, where the relationship between the contracting parties is that of master and servant, father and son, doctor and patient, solicitor and client, etc., or where one of the parties to the contract is an old illiterate person, there is no need of proving the use of undue influence by the party whose consent was so caused. Merely status of parties is enough to prove the existence of undue influence in these cases. Presumption of undue influence is also there, in case of a contract by or with a '*pardanashin* woman'.

C. Effect of Undue Influence

'When consent to an agreement is caused by undue influence, the agreement is a contract voidable at the option of the party whose consent was so caused. Any such contract may be set aside either absolutely or, if the party who was entitled to avoid it has received any benefit thereunder, upon such terms and conditions as the court may seem just' (Sec. 19-*A*).

2.5.8 Distinction Between Coercion and Undue Influence

Both coercion and undue influence vitiate consent and make the consent of one of the parties to the contract unfree. But the following are the points of distinction between the two:

1. In coercion, the consent of the aggrieved party is obtained by committing or threatening to commit an act forbidden by the Indian Penal Code or detaining or threatening to detain some property unlawfully. While in undue influence, the consent of the aggrieved party is affected from the domination of the will of one person over another.
2. Coercion is mainly of a physical character involving mostly use of physical or violent force, whereas undue influence is of moral character involving use of moral force or mental pressure.
3. There is no presumption of coercion by law under any circumstance. The burden of proof that coercion was used lies on the party whose consent was so caused. In the case of undue-influence, however, there is presumption as to the same in the case of certain relationships. In these cases, there is no need of proving the use of undue-influence by the party whose consent was so caused.

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4. While in the case of rescission of a contract procured by coercion, any benefit received by the aggrieved party has to be restored under Section 64 of the Contract Act; in the case of rescission of a contract procured by undue influence, as per Section 19-A, the Court has the discretion to direct the aggrieved party for restoring the benefit whether in whole or in part or set aside the contract without any direction for refund of benefit.
5. The party exercising coercion exposes himself to criminal liability under the Indian Penal Code, besides an action on contract. There is no criminal liability in case of undue influence.

2.5.9 Misrepresentation

A representation means a statement of fact made by one party to the other, either before or at the time of contract, relating to some matter essential to the formation of the contract, with an intention to induce the other party to enter into the contract. It may be expressed by words spoken or written or implied from the acts or conducts of the parties (*e.g.*, by any half statement of truth).

A representation when wrongly made, either innocently or intentionally, is termed a misrepresentation. To put it differently, misrepresentation may be *either* innocent *or* intentional or deliberate with an intent to deceive the other party. In law, for the former kind the term 'misrepresentation' and for the latter the term 'fraud' is used.

According to Section 18, 'misrepresentation' means and includes:

(a) The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true; or

(b) Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of any one claiming under him; or

(c) Causing, however innocently, a party to an agreement, to make a mistake as to the substance of the thing which is the subject of the agreement.

Thus, as per Section 18, there is misrepresentation in the following three cases:

(a) **Positive assertion of unwarranted statements of material facts believing them to be true:** If a person makes an explicit statement of fact not warranted by his information (i.e., without any reasonable ground), under an honest belief as to its truth though it is not true, there is misrepresentation.

(b) **Breach of duty which brings an advantage to the person committing it by misleading the other to his prejudice**: This clause covers those cases where a statement when made, was true but subsequently before it was acted upon, it became false to the knowledge of the person making it. In such a case, the person making the statement comes under an obligation

to disclose the change in circumstances to the other party, otherwise he will be guilty of misrepresentation.

(c) **Causing mistake about subject-matter innocently**: If one of the parties induces the other, though innocently, to commit a mistake as to the quality or nature of the thing bargained, there is misrepresentation.

A. Essentials of misrepresentation

From the foregoing discussion, it follows that for alleging misrepresentation, the following four things are necessary:

(i) There should be a representation, made innocently, with an honest belief as to its truth and without any desire to deceive the other party, either expressly or impliedly.

(ii) The representation must relate to facts material to the contract and not to mere opinion or hearsay.

(iii) The representation must be, or must have become untrue.

(iv) The representation must have been instrumental in inducing the other party to enter into a contract (As per the Explanation to Section 19).

B. Effects of Misrepresentation

In case of misrepresentation, the aggrieved party has two alternative courses open to him— (i) he can rescind the contract, treating the contract as voidable; or (ii) he may affirm the contract and insist that he shall be put in the position in which he would have been if the representation made had been true (Sec. 19). Misrepresentation does not entitle the aggrieved party to claim damages by way of interest or otherwise for expenses incurred.

Illustration: *A*, in good faith tells *B* that his TV set is made in Japan. *B*, thereupon buys the TV set. However, it turns out to be an Indian make. *A* is guilty of misrepresentation. *B* may either avoid the contract or may insist on its being carried out. In the latter case, *B* may either ask for replacing the set by a Japanese-made set or may keep the Indian-made set and claim the difference in price between that set and a Japanese-made set.

2.5.10 Fraud

The term '**fraud**' includes all acts committed by a person with an intention to deceive another person. According to Section 17, 'fraud means and includes any of the following acts committed by a party to a contract', or with his connivance, or by his agent, with intent to deceive or to induce another party thereto or his agent, to enter into the contract:

1. **The representation that a fact is true when it is not true by one who does not believe it to be true:** Thus a false statement intentionally made is fraud. An absence of honest belief in the truth of the statement made is essential to constitute fraud.

2. **The active concealment of a fact by a person who has knowledge or belief of the fact:** Active concealment of a material fact is taken as much a fraud as if the existence of such fact was expressly denied or the reverse of it expressly stated. Mere non-disclosure is not fraud, where there is no duty to disclose. *Caveat Emptor* or 'Buyer Beware' is the principle in all contracts of sale of goods. As a rule the seller is not bound to disclose to the buyer the faults in the goods he is selling.

   Illustrations: (a) *A*, a horse dealer, sells a mare to *B*. *A* knows that the mare has a cracked hoof which he fills up in such a way as to defy detection or on enquiry from *B*, *A* affirms that the mare is sound. The defect is subsequently discovered by *B*. There is 'fraud' on the part of *A* and the agreement can be voided by *B* as his consent has been obtained by fraud.

   (b) *A*, sells by auction, to *B* a horse, which he knows to be unsound. *A* says nothing to *B* about the horse's unsoundness. This is not 'fraud' because *A* is under no duty to disclose the fact to *B*, the general rule of law being 'let the buyer beware' [Illustration (a) to Section 17].

3. **A promise made without any intention of executing it**: If a man while entering into a contract has no intention to execute his promise, there is fraud on his part.

4. **Any other act fitted to deceive**: 'The fertility of man's invention in devising new schemes of fraud is so great that it would be difficult, if not impossible, to confine fraud within the limits of any exhaustive definition. All surprise, trick, cunning, dissembling and other unfair way that is used to cheat anyone is considered fraud and sub-section (4) is obviously intended to cover all those cases of fraud which cannot appropriately be covered by the other subsections.

5. **Any such act or omission as the law specially declares to be fraudulent:** This subsection refers to the provisions in certain Acts which make it obligatory to disclose relevant facts. Thus, for instance, under Section 55 of the Transfer of Property Act, the seller of immovable property is bound to disclose to the buyer all material defects in the property (e.g., the roof has a crack) or in the seller's title (e.g., the property is mortgaged). An omission to make such a disclosure amounts to fraud.

Thus, in order to allege fraud, the act complained of must be brought within the scope of the acts enumerated above. A mere expression of opinion or commendatory expression is not fraud. 'The land is very fertile' is simply a statement of opinion *or* 'our products are the best in the market' is merely a commendatory expression. Such statements do not ordinarily amount to fraud.

A. Can Silence be Fraudulent?

The explanation to Section 17 deals with cases as to when 'silence is fraudulent' or what is sometimes called 'constructive fraud.' The explanation declares that

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'mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, *unless*—

(i) The circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or

(ii) Silence is, in itself, equivalent to speech.' It therefore follows that—

1. As a rule, mere silence is not fraud because there is no duty cast by law on a party to a contract to make a disclosure to the other party of material facts within his knowledge.
2. Silence is fraudulent, if the circumstances of the case are such that 'it is the duty of the person keeping silence to speak'. In other words, silence is fraudulent in contracts of 'utmost good faith' *i.e.*, contracts '*uberrimae fidei*.' For example, the following contracts come within the class of '*uberrimae fidei'* contracts:
   (a) **Contract of marriage engagement***:* Every material fact must be disclosed by both parties to a contract of marriage otherwise the other party is justified in breaking off the engagement (*Haji Ahmed vs Abdul Gani*.)
   (b) **Share allotment contracts***:* Promoters and directors, who issue the prospectus of a company to invite the public to subscribe for shares and debentures, possess information which is not available to the general public and as such they are required to disclose all information regarding the company with strict and scrupulous accuracy.
3. Silence is fraudulent where the circumstances are such that 'silence is, in itself, equivalent to speech'. Where, for example, *B* says to *A* — 'If you do not deny it, I shall assume that the horse is sound.' *A* says nothing. Hence *A's* silence is equivalent to speech. If the horse is unsound *A's* silence is fraudulent.

B. Effect of Fraud

A party who has been induced to enter into a contract by fraud, has the following remedies open to him. These are as follows:

1. He can *rescind* the contract, i.e., he can avoid the performance of the contract; being voidable at his option (Sec. 19).
2. He can ask for *restitution* and insist that the contract shall be performed, and that he shall be put in the position in which he would have been, if the representation made had been true (Sec. 19).
3. The aggrieved party can also sue for *damages*, if any. Fraud is a 'civil wrong' hence compensation is payable. For instance, if the party suffers injury because of unsound horse, which was not disclosed despite enquiry, compensation can be demanded. Similarly, where a man was fraudulently

induced to buy a house, he was allowed to recover the expense involved in moving into the house as damages (in addition to rescission of the contract) [*Doyle vs Olby* (*Ironmongers*) *Ltd*.].

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C. Distinction between Fraud and Misrepresentation

The following are the points of distinction between fraud and misrepresentation:

1. Fraud implies an intention to deceive, it is deliberate or wilful; whereas misrepresentation is innocent without any intention to deceive.
2. Fraud is a civil wrong which entitles a party to claim damages in addition to the right of rescinding the contract. Misrepresentation gives only the right to avoid the contract and there can be no suit for damages.
3. In case of misrepresentation, the fact that the aggrieved party had the means to discover the truth with ordinary diligence will prevent the party from avoiding the contract. But in case of fraud, excepting fraud by silence, the contract is voidable even though the party defrauded had the means of discovering the truth with ordinary diligence.

2.5.11 Mistake

Mistake may be defined as an erroneous belief concerning something. It may be of two kinds: Mistake of law, and Mistake of fact.

1. Mistake of Law

Mistake of law may be of two types:

(i) **Mistake of law of the country *or* mistake of law:** Everyone is deemed to be conversant with the law of his country, and hence the maxim 'ignorance of law is no excuse'. Mistake of law, therefore, is no excuse and it does not give right to the parties to void the contract. Stating the effect of mistake as to law, Section 21 declares that 'a contract is not voidable because it was caused by a mistake as to any law in force in India'. Accordingly, no relief can be granted on the ground of mistake of law of the country.

However, if one of the parties makes a 'mistake of law' through the inducement, whether innocent or otherwise, of the other party, the contract may be voided.

(ii) **Mistake of foreign law:** Mistake of foreign law stands on the same footing as the 'mistake of fact'. Here the agreement is void in case of 'bilateral mistake' only, as explained under the subsequent heading.

2. Mistake of Fact

Mistake of fact may be of two types:

i. **Bilateral mistake:** Where the parties to an agreement misunderstood each other and are at cross purposes, there is a bilateral mistake. Here, there is

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no real correspondence of offer and acceptance, each party obviously understanding the contract in a different way. In fact in such cases, there is no agreement at all, there being *entire absence* of consent. In case of bilateral mistake of essential fact, the agreement is void *ab-initio*. Section 20 provides that 'where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void'. Thus for declaring an agreement void *ab-into* under this Section, *the fact must be essential to the agreement,* i.e., the fact must be such which goes to the very root of the agreement.

ii. **Unilateral mistake:** Where only one of the contracting parties is mistaken as to a matter of fact, the mistake is a unilateral mistake. Regarding the effect of unilateral mistake on the validity of a contract. Section 22 provides that 'a contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact'. Accordingly, in case of unilateral mistake a contract remains valid unless the mistake is caused by misrepresentation or fraud, in which case the contract is voidable at the option of aggrieved party. On the basis of judicial decisions, however, in certain exceptional cases even a unilateral mistake, whether caused by fraud, misrepresentation, etc., or otherwise, may make an agreement void *ab-initio.*

Check Your Progress

1. Define 'contract'.
2. List some essential elements of a valid contract.
3. What are the types of contract on the basis of mode of creation?

2.6 MODES OF DISCHARGE OF CONTRACTS

When the rights and obligations arising out of a contract are extinguished, the contract is said to be discharged or terminated. A contract may be discharged in any of the following ways:

1. By performance—actual or attempted.
2. By mutual consent or agreement.
3. By subsequent or supervening impossibility or illegality.
4. By lapse of time.
5. By operation of law.
6. By breach of contract.

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1. Discharge by Performance

Performance of a contract is the principal and most usual mode of discharge of a contract. Performance may be: (i) Actual performance; or (ii) Attempted performance or Tender.

i. **Actual performance**. When each party to a contract fulfils his obligation arising under the contract within the time and in the manner prescribed, it amounts to actual performance of the contract and the contract comes to an end or stands discharged. But if one party only performs his promise, he alone is discharged. Such a party gets a right of action against the other party who is guilty of breach.

ii. **Attempted performance or tender**. When the promisor offers to perform his obligation under the contract, but is unable to do so because the promisee does not accept the performance, it is called 'attempted performance' or 'tender'. Thus 'tender' is not actual performance but is only an 'offer to perform' the obligation under the contract. A *valid tender* of performance is equivalent to performance.

A. Essentials of a valid tender

A valid tender or offer of performance must fulfil the following conditions:

(i) It must be *unconditional.* A conditional tender is no tender.

(ii) It must be made at *proper time and place*. A tender before or after the due date or at a place other than agreed upon is not a valid tender.

(iii) It must be of the *whole obligation* contracted for and not only of the part. Thus deciding of his own to pay in instalments and offering the first instalment was held an invalid tender as it was not of the whole amount due (*Behari Lal vs Ram Gulam*).

(iv) If the tender relates to delivery of goods, it must give a *reasonable opportunity to the promisee for inspection of goods* so that he may be sure that the goods tendered are of contract description.

(v) It *must be made by a person* who is in a position and is willing to perform the promise. A tender by a minor or idiot is not a valid tender.

(vi) It *must be made to the proper person*, i.e., the promisee or his duly authorized agent. Tender made to a stranger is invalid.

(vii) If there are several joint promisees, an offer to any one of them is a valid tender. But the actual payment must be made to all joint promisees, and not to any one of them, for a valid discharge of the contract, for, Section 45 provides that when a promise is made to two or more persons jointly, the right to claim performance rests with all of them jointly.

(viii) In case of tender of money, exact amount should be tendered in the legal tender money.

B. Effect of refusal to accept a valid tender

The effect of refusal to accept a properly made 'offer of performance' is that the contract is deemed to have been performed by the promisor, i.e., tenderer, and the promisee can be sued for breach of contract. A valid tender, thus, discharges the contract. (Section 38).

Exception. Tender of money, however, does not discharge the contract. The money will have to be paid even after the refusal of tender, of course without interest from the date of refusal. In case of a suit, cost of defence can also be recovered from the plaintiff, if tender of money is proved (*Jagat Tarini vs Naba Gopal*).

2. Discharge by Mutual Consent or Agreement

Since a contract is created by means of an agreement, it may also be discharged by another agreement between the same parties. Sections 62 and 63 deal with this subject and provide for the following methods of discharging a contract by mutual agreement:

i. **Novation**: 'Novation occurs when a new contract is substituted for an existing contract, either between the same parties or between different parties, the consideration mutually being the discharge of the old contract. If parties are not changed then the nature of the obligation (i.e., material terms of the contract) must be altered substantially in the new substituted contract, for a mere variation of some of the terms of a contract, while the parties remain the same, is not 'novation' but 'alteration'. When the parties to a contract agree for 'novation', the original contract is discharged and need not be performed.

   The following points are also worth noting in connection with novation:

   (a) Novation cannot be compulsory, it can only be with the mutual consent of all the parties.

   (b) The new contract must be valid and enforceable. If it suffers from any legal flaw, e.g., want of proper stamp or registration etc., on account of which it becomes unenforceable, then the original contract revives (*Mahabir Prasad vs Satyanarain*).

ii. **Alteration:** Alteration of a contract means change in one or more of the material terms of a contract. If a material alteration in a written contract is done by mutual consent, the original contract is discharged by alteration and the new contract in its altered form takes its place. A material alteration is one which alters the legal effect of the contract, *e.g.,* a change in the amount of money to be paid or a change in the rate of interest. Immaterial alteration, e.g., correcting a clerical error in figures or the spelling of a name, has no effect on the validity of the contract and does not amount to alteration in the technical sense.

   It is relevant to state that a material alteration made in a written contract by one party without the consent of the other, will, make the whole contract

void and no person can maintain an action upon it. It comes under 'discharge of a contract by operation of law' which will be discussed later.

The difference between 'novation' and 'alteration' may be noted. In case of novation, there may be a change of parties also while in case of alteration parties remain, the same, only the terms of a contract are altered.

iii. **Rescission:** A contract may be discharged, before the date of performance, by agreement between the parties to the effect that it shall no longer bind them. Such an agreement amounts to 'rescission' or cancellation of the contract, the consideration for mutual promises being the abandonment by the respective parties of their rights under the contract. An agreement of rescission releases the parties from their obligations arising out of the contract. Such agreements are to be distinguished from 'agreements in restraint of legal proceedings' which are void as per Section 28. Law cannot force the parties to take a legal action for breach of contract and, therefore, if they consent to treat non-performance or part performance of a contract equivalent to full performance or discharge of the contract, it is perfectly alright.

iv. **Remission:** Remission may be defined 'as the acceptance of a lesser sum than what was contracted for *or* a lesser fulfilment of the promise made'.

Section 63 deals with remission of performance and lays down that a promisee may remit or give up wholly or in part, the performance of the promise made to him, and a promise to do so is binding even though there is no consideration for it. The Section further provides that an agreement to extend the time for the performance of a promise also does not require consideration to support it on the ground that it is a partial remission of performance.

v. **Waiver**: Waiver means the deliberate abandonment or giving up of a right which a party is entitled to under a contract, whereupon the other party to the contract is released from his obligation. Strictly speaking, there is no need of an agreement for a waiver but because we are discussing it as a method of discharge under 'mutual consent', we presume that the other party consents to it.

3. Discharge by Subsequent or Supervening Impossibility or Illegality

i. Impossibility at the time of contract: There is no question of discharge of a contract which is entered into to perform something that is *obviously impossible,* e.g., an agreement to discover treasure by magic, because, in such a case there is no contract to terminate, it being an agreement void *ab-initio* by virtue of Section 56, Para I, which provides: 'an agreement to do an act impossible in itself is void.' Notice that this paragraph of the Section speaks of something which is impossible inherently or by its very nature and which may or may not be known to both the parties at the time when the contract is made.

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ii. **Subsequent impossibility:** In fact it is this case, where the impossibility supervenes after the contract has been made, which is material to our study of discharge of contracts. In this connection, Section 56, Para 2, declares: 'A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful'.

    In order that the Section would apply the following conditions must be fulfilled: (1) that the act should have become impossible; (2) that impossibility should be by reason of some event which the promisor could not prevent; and (3) that the impossibility should not be self-induced by the promisor or due to his negligence. Further, the word 'impossible' should be construed here in its practical sense and not only in a physical or literal sense.

    Thus, under Section 56 (Para 2), where an event which could not reasonably have been in the contemplation of the parties when the contract was made, renders performance impossible or unlawful, the contract becomes void and stands discharged. This is known as frustration of the contract brought about by supervening impossibility. It is also known as *the doctrine of supervening impossibility*. The rationale behind the doctrine is that if the performance of a contract becomes impossible by reason of supervening impossibility or illegality of the act agreed to be done, it is logical to absolve the parties from further performance of it as they never did promise to perform an impossibility.

iii. **Cases where the doctrine of supervening impossibility applies.** A contract will be discharged on the ground of supervening impossibility in the following cases:

    1. **Destruction of subject-matter:** When the subject-matter of a contract, subsequent to its formation, is destroyed, without the fault of the promisor or promisee, the contract is discharged. Note that it is so only when specific property or goods are destroyed which cannot be regained.
    2. **Failure of ultimate purpose**: Where the ultimate purpose for which the contract was entered into fails, the contract is discharged, although there is no destruction of any property affected by the contract and the performance of the contract remains possible in literal sense.
    3. **Death or personal incapacity of promisor**: Where the performance of a contract depends upon the personal skill or qualification or the existence of a given person, the contract is discharged on the illness or incapacity or the death of that person.
    4. **Change of law:** A subsequent change in law may render the contract illegal and in such cases the contract is deemed discharged. The law may actually forbid the doing of some act undertaken in the contract, or it may take from the control of the promisor something in respect of which he has contracted to act or not to act in a certain way.

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5. **Outbreak of war:** All contracts entered into with an alien enemy during war are illegal and void *ab-initio*. Contracts entered into before the outbreak of war are suspended during the war and may be revived after the war is over provided they have not already become time-barred.

iv. **Cases not Covered by Supervening Impossibility:** "He that agrees to do an act must do it or pay damages for not doing it", is the general rule of the law of contract. Thus, unless the performance becomes absolutely impossible (as discussed above), a person is bound to perform any obligation which he has undertaken, and cannot claim to be excused by the mere fact that performance has subsequently become unexpectedly burdensome, more difficult or expensive. Some of the cases where impossibility of performance is not an excuse are as follows:

1. **Difficulty of performance:** Increased or unexpected difficulty and expense do not, as a rule, excuse from performance.
2. **Commercial impossibility:** When in a transaction profits dwindle to a very low level or actual loss becomes certain, it is said that the performance of the contract has become commercially impossible. Such a situation may arise on account of higher price of the raw material or increase in the wage bill etc. Commercial impossibility also does not discharge a contract (*Sachindra vs Gopal*).
3. **Impossibility due to the default of a third person**: The doctrine of supervening impossibility does not cover cases where the contract could not be performed because of the impossibility created by the failure of a third person on whose work the promisor relied.
4. **Strikes and lock-outs:** *A* strike by the workmen or a lock-out by the employer also does not excuse performance because the former is *manageable* (as labour is available otherwise) and the latter is *self-induced*. Where the impossibility is not absolute or where it is due to the default of the promisor himself, Section 56 would not apply. As such these events also do not discharge a contract.
5. **Failure of one of the objects:** When a contract is entered into for several objects, the failure of one of them does not discharge the contract.

4. Discharge by Lapse of Time

The Limitation Act lays down that in case of breach of a contract legal action should be taken within a specified period, called the period of limitation, otherwise the promisee is debarred from instituting a suit in a court of law and the contract stands discharged. Thus in certain circumstances lapse of time may also discharge a contract. For example, the period of limitation for simple contracts is three years under the Limitation Act, and therefore on default by a debtor if the creditor does not file a suit of recovery against him within three years of default, the debt becomes

time-barred on the expiry of three years and the creditor will be deprived of his remedy at law. This in effect implies discharge of contract.

5. Discharge by Operation of Law

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A contract terminates by operation of law in the following cases:

(a) **Death:** Where the contract is of a personal nature, the death of the promisor discharges the contract. In other contracts, the rights and liabilities of the deceased person pass on to the legal representatives of the dead man.

(b) **Insolvency:** A contract is discharged by the insolvency of one of the parties to it when an Insolvency Court passes an "order of discharge" exonerating the insolvent from liabilities on debts incurred prior to his adjudication.

(c) **Merger:** Where an inferior right contract merges into a superior right contract, the former stands discharged automatically.

(d) **Unauthorized material alteration:** A material alteration made in a written document or contract by one party without the consent of the other, will make the whole contract void. Thus, where the amount of money to be received is altered, or an additional signature is forged, on a promissory note by a creditor, he cannot bring a suit on it and the pro-note cannot by enforced against the debtor even in its original shape. The effect of making such an alteration is exactly the same as that of cancelling the contract (*Gour Chunder vs Prasanna*). However, the document, though altered, can be used as proof of the transaction and the creditor may be allowed to claim refund of money actually advanced by him under Section 65 of the Contract Act which is based on the equitable doctrine of restitution (*Ananthrao vs Kandikanda*).

6. Discharge by Breach of Contract

Breach of contract by a party thereto is also a method of discharge of a contract, because 'breach' also brings to an end the obligations created by a contract on the part of each of the parties. Of course the aggrieved party, i.e., the party not at fault can sue for damages for breach of contract as per law; but the contract as such stands terminated.

2.7 REMEDIES FOR BREACH OF CONTRACT

Breach of contract, as explained above, may be of two kinds: (1) Anticipatory breach and (2) Actual breach.

1. **Anticipatory breach:** An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. It may take place in two ways:

   (a) ***Expressly by words spoken or written***: Here, a party to the contract communicates to the other party, before the due date of performance,

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his intention not to perform it. For example, *A* contracts with *B* to supply 100 bags of wheat for ` 60,000 on 1st March. On 15th February, *A* informs *B* that he will not be able to supply the wheat. There is express rejection of the contract.

(b) **Impliedly by the conduct of one of the parties**: Here a party by his own voluntary act disables himself from performing the contract. For example, (i) a person contracts to sell a particular horse to another on 1st of June and before that date he sells the horse to somebody else; (ii) *A* agrees to marry *B* but before the agreed date of marriage she marries *C*. In both the above cases there occurs an anticipatory breach of contract brought about by the conduct of one of the parties.

Section 39 of the Contract Act deals with anticipatory breach of contract and provides as follows: 'When a party to a contract has refused to perform, or disabled himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance'

Effect of an anticipatory breach: When there is an anticipatory breach of contract, the promisee is excused from performance or from further performance. Further, it gives an option to the promisee (i.e., the aggrieved party) whereby:

(i) He may either treat the contract as rescinded and sue the other party for damages for breach of contract immediately without waiting until the due date of performance, or

(ii) He may elect not to rescind but to treat the contract as still operative, and wait for the time of performance and then hold the other party responsible for the consequences of non-performance. But in that case, he will keep the contract alive for the benefit of the other party as well as his own, and the guilty party, if he so decides on reconsideration, may still perform his part of the contract and can also take advantage of any supervening impossibility which may have the effect of discharging the contract.

2. **Actual breach.** Actual breach may also discharge a contract. It occurs when a party fails to perform his obligation upon the date fixed for performance by the contract, as for example, where on the appointed day the seller does not deliver the goods or the buyer refuses to accept the delivery. It is important to note that there can be no actual breach of contract by reason of non-performance so long as the time for performance has not yet arrived. Actual breach entitles the party not in default to elect to treat the contract as discharged and to sue the party at fault for damages for breach of contract.

Whenever there is breach of a contract, the injured party becomes entitled to any one or more of the following remedies against the guilty party:

1. Rescission of the contract
2. Suit for damages
3. Suit upon *quantum meruit*
4. Suit for specific performance of the contract
5. Suit for an injunction

As regards the last two remedies stated above, the law is regulated by the Specific Relief Act, 1963.

1. Rescission of the Contract

When there is a breach of contract by one party, the other party may rescind the contract and need not perform his part of obligations under the contract and may sit quietly at home if he decides not to take any legal action against the guilty party. But in case the aggrieved party intends to sue the guilty party for damages for breach of contract, he has to file a suit for rescission of the contract. When the court grants rescission, the aggrieved party is freed from all his obligations under the contract; and becomes entitled to compensation for any damage which he has sustained through the non-fulfilment of the contract (Sec. 75).

Thus, applying to the court for 'rescission of the contract' is necessary for claiming damages for breach or for availing any other remedy. In practice a 'suit for rescission' is accompanied by a 'suit for damages,' etc., in the same plaint.

2. Suit for Damages

Damages are a monetary compensation allowed to the injured party for the loss or injury suffered by him as a result of the breach of contract. The fundamental principle underlying damages is not punishment but compensation. By awarding damages the court aims to put the injured party into the position in which he would have been, had there been performance and not breach, and not to punish the defaulter party. As a general rule, 'compensation must be commensurate with the injury or loss sustained, arising naturally from the breach.' 'If actual loss is not proved, no damages will be awarded.'

Different kinds of damages. Damages may be of four kinds:

1. Ordinary (Sec. 73)
2. Special damages (Sec. 73)
3. Exemplary, Punitive or Vindictive damages
4. Nominal damages

1. **Ordinary Damages:** When a contract has been broken, the injured party can, as a rule, always recover from the guilty party ordinary or general damages. These are such damages as may fairly and reasonably

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be considered *as arising naturally and directly in the usual course of things* from the breach of contract itself. In other words, ordinary damages are restricted to the “direct or proximate consequences” of the breach of contract and remote or indirect losses, which are not the natural and probable consequence of the breach of contract, are generally not regarded.

2. **Special Damages:** Special damages are those which arise on account of the special or unusual circumstances affecting the plaintiff. In other words, they are such remote losses which are not the natural and probable consequence of the breach of contract. Unlike ordinary damages, special damages cannot be claimed as a matter of right. These can be claimed only if the special circumstances which would result in a special loss in case of breach of contract are brought to the notice of the other party. It is important that such damages must be in contemplation of the parties at the time when the contract is entered into. Subsequent knowledge of the special circumstances will not create any special liability on the guilty party.
3. **Exemplary or Vindictive Damages:** These are such damages which are awarded with a view to punishing the guilty party for the breach and not by way of compensation for the loss suffered by the aggrieved party. As observed earlier, the cardinal principle of the law of damages for a breach of contract is to compensate the injured party for the loss suffered and not to punish the guilty party. Hence, obviously, exemplary damages have no place in the law of contract and are not recoverable for a breach of contract. There are, however, two exceptions to this rule:
   (a) **Breach of a contract to marry**: In this case, the amount of the damages will depend upon the extent of injury to the party’s feelings. One may be ruined, other may not mind so much.
   (b) **Dishonour of a cheque by a banker when there are sufficient funds to the credit of the customer**: In this case the rule of ascertaining damages is, ‘the smaller the cheque, the greater the damage’. Of course, the actual amount of damages will differ according to the status of the party.
4. **Nominal Damages:** Nominal damages are those which are awarded only for the namesake. These are neither awarded by way of compensation to the aggrieved party nor by way of punishment to the guilty party. These are awarded to establish the right to decree for breach of contract when the injured party has not actually suffered any real damage, and consist of a very small sum of money, say, a rupee or two.

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Liquidated Damages and Penalty

Let us first know what we mean by the two terms. 'Liquidated damages' means a sum fixed up in advance, which is a fair and genuine pre-estimate of the probable loss that is likely to result from the breach. 'Penalty' means a sum fixed up in advance, which is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach. Thus, the essence of a penalty is a payment of money stipulated as *in terrorem* of the offending party.

Sometimes the parties fix up at the time of the contract the sum payable as damages in case of breach. In such a case, a distinction is made in English Law as to whether the provision amounts to 'liquidated damages' or a 'penalty'. Courts in England usually allow 'liquidated damages' as stipulated in the contract, without any regard to the actual loss sustained. 'Penalty' clauses, however, are treated as invalid and the courts in that case calculate damages according to the ordinary principles and allow only reasonable compensation.

Under the Indian Law, Section 74 does away with the distinction between liquidated damages' and 'penalty'. This Section lays down that the courts are not bound to treat the sum mentioned in the contract, either by way of liquidated damages or penalty, as the sum payable as damages for breach. Instead the courts are required to allow reasonable compensation so as to cover the actual loss sustained, not exceeding the amount so named in the contract. Thus, according to the Section, the named sum, regardless whether it is a penalty or not, determines only the maximum limit liability in case of the breach of contract. The section does not confer a special benefit upon any party; it merely declares the law that notwithstanding any term in the contract pre-determining damages or providing for forfeiture of any property by way of penalty, the Court will award to the party aggrieved only reasonable compensation not exceeding the amount named or penalty stipulated.

Exception. There is, however, one exception provided for by Section 74 to the above rule. When any person enters into any bail-bond, recognizance or other instrument of the same nature, or under the provisions of any law or under the orders of the Government, gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable to pay *the whole sum* mentioned therein upon breach of the condition of any such instrument.

Cost of suit. The aggrieved party is entitled, in addition to the damages, to get the costs of getting the decree for damages from the defaulter party. The cost of suit for damages is in the discretion of the court.

3. Suit Upon *Quantum Meruit*

The third remedy for a breach of contract available to an injured party against the guilty party is to file a suit upon *quantum meruit*. The phrase *quantum meruit* literally means 'as much as is earned' or 'in proportion to the work done.' A right

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to sue upon *quantum meruit* usually arises where after part performance of the contract by one party, there is a breach of contract, or the contract is discovered void or becomes void.

Illustrations:

(a) *A* engages *B*, a contractor, to build a three-storey house. After a part is constructed *A* prevents *B* from working any more. *B*, the contractor, is entitled to get reasonable compensation for work done under the doctrine of *quantum meruit* in addition to the damages for breach of contract.

(b) A contracts with *B* to repair his house at a piece rate. After a part of the repairs have been carried out, the house is destroyed by lightning. Although the contract becomes void and stands discharged because of destruction of the house, *A* can claim payment for the work done on *quantum meruit*. Note that if under the contract a lump sum is to be paid for the repair job as a whole, then *A* cannot claim *quantum meruit* because no money is due till the whole job is done.

4. Suit for Specific Performance

Specific performance means the actual carrying out of the contract as agreed. Under certain circumstances an aggrieved party may file a suit for specific performance, i.e., for a decree by the court directing the defendant to actually perform the promise that he has made.

A decree for specific performance is not granted for contracts of every description. It is only where it is just and equitable so to do, i.e., where the legal remedy is inadequate or defective, that the courts issue a decree for specific performance. It is usually granted in contracts connected with land, buildings, rare articles and unique goods having some special value to the party suing because of family association. Notice that in all these contracts, monetary compensation is not an adequate relief because the injured party will not be able to get an exact substitute in the market.

Specific performance is not granted, as a rule, in the following cases:

(i) Where monetary compensation is an adequate relief. Thus, the courts refuse specific performance of a contract to lend or to borrow money or where the contract is for the sale of goods easily procurable elsewhere.

(ii) Where the court cannot supervise the actual execution of the contract, e.g., a building construction contract. Moreover, in most cases, damages afford an adequate remedy.

(iii) Where the contract is for personal services, e.g., a contract to marry or to paint a picture. In such contracts 'injunction' (i.e., an order which forbids the defendant to perform a similar personal service for other persons) is granted in place of specific performance.

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5 Suit for an Injunction

'Injunction' is an order of a court restraining a person from doing a particular act. It is a mode of securing the specific performance of the negative terms of the contract. To put it differently, where a party is in breach of negative term of the contract. (i.e., where he is doing something which he promised not to do), the court may, by issuing an injunction restrain him from doing, what he promised not to do. Thus 'injunction' is a preventive relief. It is particularly appropriate in cases of 'anticipatory breach of contract' where damages would not be an adequate relief.

Check Your Progress

4. List the different categories of reciprocal promises.
5. What are main essentials of a valid tender?

2.8 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A 'contract' is an agreement, the object of which is to create a legal obligation, i.e., a duty enforceable by law.
2. The essential elements of a valid contract are:
   (a) Offer and acceptance
   (b) Lawful consideration
   (c) Capacity of parties
   (d) Free consent
   (e) Writing and registration
3. The types of contract on the basis of mode of creation are:
   (a) Express contract
   (b) Implied contract
   (c) Constructive or quasi-contract
4. Reciprocal promises may be classified into three categories: (1) Mutual and Independent, (2) Mutual and Dependent, and (3) Mutual and Concurrent. Sections 51 to 54 of the Contract Act lay down the rules regarding the order of performance of reciprocal promises.
5. A valid tender or offer of performance must fulfil the following conditions:
   (i) It must be unconditional. A conditional tender is no tender.
   (ii) It must be made at proper time and place. A tender before or after the due date or at a place other than agreed upon is not a valid tender.

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(iii) It must be of the whole obligation contracted for and not only of the part.

(iv) If the tender relates to delivery of goods, it must give a reasonable opportunity to the promisee for inspection of goods so that he may be sure that the goods tendered are of contract description.

(v) It must be made by a person who is in a position and is willing to perform the promise. A tender by a minor or idiot is not a valid tender.

2.9 SUMMARY

- Contract is an agreement, the object of which is to create a legal obligation, i.e., a duty enforceable by law. The law of contract in India is contained in the Indian Contract Act, 1872. Contract consists of two elements—agreement and legal obligation.
- Section 2 (a) of the Indian Contract Act defines a proposal as when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal.
- According to Section 10, all agreements are contracts if they are made by the free consent of the parties competent to contract, for a lawful consideration, with a lawful object, are not expressly declared by the Act to be void, and, where necessary, satisfy the requirements of any law as to writing or attestation or registration.
- When contracting parties are face to face and negotiate in person, there is instantaneous communication of offer and acceptance, and a valid contract comes into existence the moment the offeree gives his absolute and unqualified acceptance to the proposal made by the offeror.
- Section 2 (d) of the Indian Contract Act defines consideration as when at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a 'consideration for the promise'.
- According to Section 11, a person is incompetent to contract if he is a minor, according to the law to which he is subject; he is of unsound mind, or if he is disqualified from contracting by any law to which he is subject.
- The Constitution of India guarantees the freedom of trade and commerce to every citizen and therefore Section 27 declares 'every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void'.
- A contract brought about by coercion is voidable at the option of the party whose consent was so caused. This means that the aggrieved party may

either exercise the option to affirm the transaction and hold the other party bound by it, or repudiate the transaction by exercising a right of rescission.

- An unenforceable contract is one which is valid in itself, but is not capable of being enforced in a court of law because of some technical defect such as absence of writing, registration, requisite stamp, etc., or time barred by the law of limitation.
- A representation when wrongly made, either innocently or intentionally, is termed as 'misrepresentation'. To put it differently, misrepresentation may be either innocent or intentional or deliberate with an intent to deceive the other party.

2.10 KEY WORDS

- **Contract:** It is an agreement enforceable by law.
- **Promise:** It is a proposal after acceptance.
- **Unenforceable contract:** It is a contract which is valid in itself, but is not capable of being enforced in a court of law because of some technical defect.
- **Executed contract:** When both parties to a contract have completely performed their share of obligations and nothing remains to be done by either party under the contract, it is known as executed contract.

2.11 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write in brief about the legal obligation in a contract.
2. Write a short note on the essential features of contract.
3. Write a short note on breach of contract.
4. State the mode of discharge of contract.

Long-Answer Questions

1. 'All contracts are agreements, but all agreements are not contracts'. Justify the statement.
2. Analyse the various types of contracts on the basis of enforceability.
3. Discuss in detail the circumstances when an offer lapses and becomes invalid.
4. Discuss the conditions when a person is incompetent to contract.

2.12 FURTHER READINGS

NOTES

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UNIT 3 LAW OF AGENCY

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Structure

3.0 INTRODUCTION

In this unit, you will learn about the concept of 'agency'. Section 182 of the Contract Act explains that an 'agent' is one who is employed to do any act on behalf of or represents another person or entity (such as a firm). A 'principal' is the person or entity who is represented by an agent. An agency is the contract between a principal and an agent. You will also read about the general rules that are in operation agencies and how one is created. There are various ways an agency can be created, such as by an implied or expressed agreement, or by necessity. Finally, you will learn how an agency can be terminated. Sections 203–207 of the Contract Act provide the legal guidelines for the termination of an agency by the parties involved. Sections 201 and 209 of the Act explain how an agency comes to an end automatically by the operation of law.

3.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the general rules of agency
- Identify the various types of agents
- Recognize different ways of creation of an agency
- Interpret how an agency can be terminated
- Understand what is an irrevocable agency

3.2 AGENT, AGENCY AND PRINCIPAL: AN OVERVIEW

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The two terms — 'agent' and 'principal'— have been defined in Section 182 of the Contract Act as follows:

'An *agent* is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is represented, is called the *principal*.'

The contract which creates the relationship of 'principal' and 'agent' is called an 'agency'. Thus where *A* appoints *B* to buy ten bags of sugar on his behalf, *A* is the 'principal,' *B* is the 'agent' and the contract between the two is 'agency.' If, in pursuance of the contract of agency, the 'agent' purchases the bags of sugar from *C*, a wholesale dealer in sugar, on credit, then in the eye of law the 'principal' and the wholesale dealer are brought into direct contractual relations and the contract of purchase is enforceable both by and against the 'principal.'

It will be seen that under a contract of agency the agent is authorised to establish privity of contract between the principal (his employer) and a third party. As such the function of an agent is essentially to bring about contractual relations between the principal and third parties. In a way, therefore, an agent is merely a connecting link. After entering into a contract on behalf of the principal with a third party, the agent drops out and ceases to be a party to the contract and the contract binds the principal and the third party as if they have made it themselves.

3.2.1 General Rules of Agency

There are two important general rules regarding agency. These are:

1. Whatever a person competent to contract may do by himself, he may do through an agent, except for acts involving personal skill and qualifications. In fact, where the work to be done is obviously personal, no agent can be employed. For example, a person cannot marry through an agent, cannot paint a picture through an agent, and so on.
2. 'He who does through another, does by himself.' In other words, 'the acts of the agent are, for all legal purposes, the acts of the principal.' Section 226 provides to the same effect: 'Contracts entered into through an agent, and obligations arising from acts done by an agent, may be enforced in the same manner, and will have the same legal consequences, as if the contracts had been entered into and the acts done by the principal in person.'

Agency exists 'whenever a person has the authority to act on behalf of the other and to create contractual relations between that other and third persons.' When this kind of power is not enjoyed, the relationship is not one of agency. Thus a person is not an agent merely because he gives another advice in matters of business (*Mahesh Chandra* vs *Radha Kishore*). Similarly, a person rendering

personal service to his master or working in his factory cannot be called an agent because in these cases he is not acting for another in dealings with third persons. It is only when one acts as a representative of the other in business dealings so as to create contractual relations between that other and third persons, that he is an agent and there is an agency (*Krishna* vs *Ganapathi*). The following aspects need to be taken into account while discussing the role of agent. These are:

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(a) Distinction between Agent and Servant

A servant acts under the direct control and supervision of his employer, that is, he has to act according to the orders of the master in every particular case. He does not create relations between his employer and third persons and cannot bind the master to third parties. If, for some purpose, he is authorised to bind the master, then to that extent he is an agent.

An agent is not subject to the direct control and supervision of the principal. He has often a large discretion to act within the scope of his authority. A 'principal' directs the agent 'as to what is to be done' while a 'master' has the further right to direct 'how the work is to be done.' Thus a very minute difference exists between the two. Further, an agent is appointed to bring the principal into contractual relations with third parties.

An agent as such is not a servant but a servant is generally for some purposes his master's agent, the extent of agency depending upon the duties or position of the servant (*Laxminarayan Ram Gopal & Sons Ltd.* vs *Hyderabad Govt.*).

(b) Distinction between Agent and Independent Contractor

An independent contractor is one who is employed to perform certain specified work but the manner and means of performance are entirely left to his discretion. He is free to do the specified job independently of the employer's control or interference. Such a contractor also differs from an agent. The main point of distinction is that while the contractor does not represent his employer in relation to other persons and as such cannot bind the employer by contracts entered into with others, the agent, on the other hand, does represent his employer in relation to other persons and can bind the employer (his principal) by contracts entered into with other persons within the scope of his authority.

(c) Who may employ an Agent?

According to Section 183, 'any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent.' As such any person competent to contract may employ an agent and a minor, a lunatic or a drunken person cannot employ an agent.

(d) Who may be an Agent?

Section 184 lays down in this regard that 'as between the principal and third persons *any person* may become an agent.' Thus even a minor or a person of

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unsound mind can be appointed as agent. It is so because the act of the agent is the act of the principal and therefore the principal is liable to third parties for the acts of a minor agent. Of course, in appointing a minor or a person of unsound mind as an agent, the principal runs a great risk because he cannot hold such an agent liable for his misconduct or negligence.

(e) No Consideration is Necessary

'No consideration is necessary to create an agency' (Sec. 185). The fact that the principal has agreed to be represented by the agent is a sufficient 'detriment' to the principal to support the contract of agency, *i.e.*, to support the promise by the agent to act in that capacity. It is to be noted, however, that a gratuitous agent is not bound to do the work entrusted to him by his principal. But once he begins the work, he is bound to complete it. Usually an agent is paid remuneration for his services.

3.2.2 Kinds of Agents

From the point of view of the extent of their authority, agents may be classified into:

1. **General agent**: A general agent is one who is employed to do all acts connected with a particular business or employment, *e.g.*, a manager of a firm. He can bind the principal by doing anything which falls within the ordinary scope of that business, whether he is actually authorised for any particular act or not, is immaterial, provided the third party acts *bona fide*. Third parties may assume that such an agent has power to do all that which is usual for a general agent to do in the business concerned.
2. **Special agent:** A special agent is one who is employed to do some particular act or represent his principal in some particular transaction, *e.g.*, an agent employed to sell a motor car. As soon as the act is performed, the authority of such an agent comes to an end. If a special agent does anything outside his authority, the principal is not bound by it, and third parties are not entitled to assume that the agent has unlimited powers. They should, therefore, make proper enquiry as to the extent of his authority before entering into any contract with him.
3. **Universal agent**: A universal agent is said to be one whose authority is unlimited, *i.e.*, who is authorised to do all the acts which the principal can lawfully do and can delegate. He enjoys extensive powers to transact every kind of business on behalf of his principal.

From the point of view of the nature of work performed by them, agents may be classified into:

1. **Mercantile agents**: A mercantile agent is one who has authority either to sell goods or to buy goods or to raise money on the security of goods [Sec. 2(9) of the Sale of Goods Act]. The various kinds of mercantile agents are as follows:

(*a*) Factor: A factor is a mercantile agent to whom goods are entrusted for sale. He enjoys wide discretionary powers in relation to the sale of goods. He sells the goods in his own name upon such terms as he thinks fit. He may pledge the goods as well.

(*b*) Commission agent: A commission agent is a mercantile agent who buys or sells goods for his principal on the best possible terms in his own name and who receives commission for his labours. He may have possession of goods or not.

(*c*) *Del credere* agent*:* He is one who in consideration of an extra commission, guarantees his principal that the third persons with whom he enters into contracts on behalf of the principal shall perform their financial obligations, that is, if the buyer does not pay, he will pay. Thus, he occupies the position of a surety as well as of an agent.

(*d*) Broker*:* He is one who is employed to make contracts for the purchase and sale of goods. He is not entrusted with the possession of goods. He simply acts as a connecting link and brings the two parties together to bargain and if the transaction materialises he becomes entitled to his commission called brokerage. He makes contracts in the name of his principal.

2. **Non-mercantile agents**: They include advocates, attorneys, insurance agent, wife, *etc*.

3.2.3 Creation of Agency

An agency may be created in any one of the following ways:

1. Agency by Express Agreement

Normally agency is created by an express agreement, specifying the scope of the authority of agent. The agent may, in such a case, be appointed either by word of mouth or by an agreement in writing (Sec. 187). However, in certain cases, *e.g*., to execute a deed for sale or purchase of land, the agent must be appointed by executing a formal 'power of attorney' on a stamped paper.

2. Agency by Implied Agreement

Implied agency arises when there is no express agreement appointing a person as an agent, but instead the existence of agency is inferred from the circumstances of the case, or from the conduct of the parties on a particular occasion, or from the relationship between parties (Sec. 187). Such an agency may take the following forms:

(*a*) Agency by estoppel

(*b*) Agency by holding out

(*c*) Agency by necessity

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We shall deal with each of these in turn.

(*a*) **Agency by estoppel**: Such an agency is based on the 'doctrine of estoppel' which may briefly be stated thus, 'Where a person by his words or conduct has wilfully led another to believe that certain set of circumstances or facts exists, and that other person has acted on that belief, he is estopped or precluded from denying the truth of such statements, although such a state of things did not in fact exist.'

Section 237 of the Contract Act, which deals with agency by estoppel, also provides to the same effect. The Section lays down that 'when an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by his words or conduct induced such third persons to believe that such acts and obligations were within the scope of agent's authority.'

We may sum up thus, an agency by estoppel is created when the alleged principal by his conduct or by words spoken or written, leads wilfully the other contracting party into an honest belief that the supposed agent had authority to act as such and bind the principal. Such a principal will be estopped from denying subsequently his agent's authority, although the agent did not in fact possess any authority whatever.

(*b*) **Agency by holding out**: Such an agency is based on the 'doctrine of holding out' which is a part of the law of estoppel. In this case also the alleged principal is bound by the acts of the supposed agent, if he has induced third persons to believe that they are done with his authority. But, unlike an 'agency by estoppel', an 'agency by holding out' requires some *affirmative or positive act or conduct* by the principal to establish agency subsequently. Thus, where an employer has been accustomed to pay for goods bought on his behalf by his employee from *P*, the employer may be liable for a purchase made in the customary manner, even though it is made, by the employee fraudulently after he has left the employment. The employer's conduct in 'holding out' his employee to be his agent (paying for purchases made by the employee on previous occasions) estops him from denying that his authority was not still in existence.

It may be noted that where the agent is 'held out' as having only a 'limited authority' to do acts, the principal is not bound by an act outside the authority.

(*c*) **Agency by necessity**: In certain circumstances the law confers an authority on one person to act as agent for another without any regard to the consent of the principal. Such an agency is called an agency of necessity. Bowstead has rightly observed: 'An agency by necessity is conferred by law in certain cases, where a person is faced with an emergency in which the property or interests of another are in imminent danger, and it becomes necessary in order to preserve the property or interests, to act before the instructions of

the owner can be obtained. The law assumes the consent of the owner to the creation of the relationship of principal and agent.' Thus, the conditions which enable a person to act as an agent of necessity of another are as follows:

(*i*) There should be a real necessity for acting on behalf of the principal.

(*ii*) It should be impossible to communicate with the principal within the time available.

(*iii*) The alleged agent should act *bona fide* in the interests of the principal.

Generally the 'agency by necessity' arises in the following cases:

(*i*) *Where the agent exceeds his authority, bona fide, in an emergency*. For example, where *A* consigns fruits to *B* at Allahabad with directions to send them immediately to *C* at Varanasi, and *B*, finding that the fruits are perishing rapidly, sells them at Allahabad itself for the best price obtainable, the sale will bind the principal and the agent cannot be held liable for exceeding his authority as under the circumstances of the case there arises agency of necessity.

(*ii*) *Where the carrier of goods acting as a bailee, does anything to protect or preserve the goods, in an emergency*, although there is no express authority in that regard. Thus a master of a ship is entitled, in cases of accident and emergency, to sell or pledge the goods in order to save their value and the sale or pledge will bind the cargo owners. Similarly, a land carrier of goods, in case of accident or emergency, becomes an agent of necessity, for example, if a public carrier develops an engine trouble, the driver can pledge a part of the goods loaded thereon in order to raise the money necessary for repairs and the pledge will be binding on the owner of goods. Notice that in these cases it is not practicable to communicate with the principal.

(*iii*) *Where a husband improperly leaves his wife without providing proper means for her sustenance*. In a special circumstance the case of husband and wife also provides an instance of agency by necessity. When the wife has been deserted by the husband and thus forced to live separate from him, the wife is regarded as the agent of necessity of the husband and she has the authority of pledging her husband's credit for necessaries even against her husband's wishes. However, this rule does not apply where the wife improperly leaves the husband.

It is relevant to state that in the ordinary course of things there is an implied agency between the husband and wife and the wife is presumed to have implied authority to pledge her husband's credit for necessaries suiting to the couple's joint style of living. But a husband enjoys no corresponding right to pledge his wife's credit for necessaries.

3. Agency by Ratification

Ratification means the subsequent adoption and acceptance of an act originally done without instructions or authority. Thus where a principal affirms or adopts the unauthorised act of his agent, he is said to have ratified that act and there comes into existence an agency by ratification retrospectively.

Section 196 deals with the effect of 'ratification.' It provides that 'where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority.'

a. *Ratification relates back to time of contract*: Ratification has got retrospective effect. By ratifying the unauthorised act of the agent, the principal becomes bound by the act as if it had been originally done by his authority. Thus ratification amounts to 'prior authority'. It relates back to the original making of the contract. This means that the agency comes into existence from the moment the agent acted and not from the time when the principal ratified.
b. *Ratification may be express or implied*: Section 197 provides; 'Ratification may be expressed or may be implied in the conduct of the person on whose behalf the acts are done.'

3.2.4 Essentials of a Valid Ratification: Principle and Agent

A valid ratification must fulfil the following conditions:

1. *The agent must purport to act as agent for a principal who is in contemplation*. The agent must expressly contract as an agent for a principal in the knowledge of third parties. The principal must be named or must be 'identifiable' and it is not sufficient to indicate simply that he is acting as agent of some one. The word 'identifiable' here means that there must be such a description of the principal as shall amount to a reasonable designation of him, for example, it would cover the expressions like 'on behalf of the Vice-Chancellor, Delhi University' or 'on behalf of my elder brother.' Thus, to be valid, a ratification must be done by the person on whose behalf the agent professed to act. An undisclosed principal cannot step in and ratify acts done by a third person. Similarly, a person entering into a contract in his own name cannot later shift it on to a third party.
2. *There should be an act capable of ratification*. The act to be ratified must be a lawful one. There can be no ratification of an illegal act or an act which is void. Thus, the shareholders of a company cannot ratify an *ultra vires* contract made by the directors.
3. *The principal must be in existence*. For a valid ratification it is essential that the principal must be in existence at the time when the original contract is made, because rights and obligations cannot attach to a non-existent

person. Thus contracts, entered into by promoters of a company on its behalf before its incorporation, cannot be ratified by the company after it comes into existence. The Specific Relief Act, however, provides for certain exceptions where a company can ratify its pre-incorporation contracts.

4. *The principal must be competent to contract*. The principal must have contractual capacity both at the time of original contract and at the time of ratification. Thus a person cannot ratify a contract made on his behalf during his minority. Similarly, a person cannot ratify a contract of insurance made by an unauthorised agent on his behalf after he has become aware that the event insured against has in fact occurred, because he could not himself insure in such circumstances (*Grover & Grover* vs *Mathews*).
5. *The principal must have full knowledge of material facts*. Section 198 declares: 'No valid ratification can be made by a person whose knowledge of facts of the case is materially defective.' Thus to constitute a valid ratification, the principal must, at the time of ratification, have full knowledge of all material facts or give such an unqualified acceptance that the inference may be drawn that he intended to ratify the contract whatever the facts may be.
6. *Whole transaction must be ratified*. Ratification must be of the whole contract. Once a part is accepted, it is an implied acceptance of the whole (Sec. 199). There cannot be partial rejection and partial ratification. The principal cannot reject the burdens attached and accept only the benefits.
7. *Within reasonable time*. A ratification to be effective must be made within a reasonable time after the original contract is made. Where a time is expressly fixed for the performance of the contract, ratification must be made within that time.
8. *Ratification must not injure a third person* (Sec. 200). A ratification cannot be effective where its effect is to subject a third person to damages, or terminate any right or interest of a third person.

Check Your Progress

1. What do you understand by the terms, 'agent' and 'principal'?
2. Define agency by estoppel.
3. List some of the essentials of valid ratification.

3.3 TERMINATION OF AGENCY

An agency may be terminated in any of the following ways:

A. By act of the parties, or
B. By operation of law

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We will consider these methods one after another.

A. Termination by act of the Parties

An agency comes to an end by act of the parties in the following cases:

1. **Agreement**: An agency, like any other contract, can be terminated at any time by the mutual agreement between the principal and the agent.
2. **Revocation by the principal** (Secs. 203 and 207): Section 203 empowers the principal to revoke the authority of the agent at any time before the agent has exercised his authority so as to bind the principal, unless the agency is irrevocable. Further, revocation may be expressed or implied in the conduct of the principal (Sec. 207). Thus where *A* empowers *B* to let *A*'s house and afterwards lets the house himself, it is an implied revocation of *B*'s authority. Revocation of authority by the principal is, however, subject to the following conditions:
   (*i*) In the case of a continuous agency, the principal may revoke it for the future. It cannot be revoked with regard to acts already done in the agency. Again, before revoking the authority for the future, reasonable notice of the same should be given to the agent and also to third parties. If reasonable notice is not given, the principal will be liable to compensate the agent for damages resulting thereby (*i.e.*, for the agent's loss of salary if no immediate job is available), and be bound by the acts of the agent with respect to third parties. (Secs. 204 and 206)
   (*ii*) Where an agency has been created for a fixed period and the principal revokes the authority of the agent before the expiry of the period, without sufficient cause, the principal is bound to pay compensation to the agent for the resulting loss, even if the authority is revoked after reasonable notice. (Sec. 205)
3. **Renunciation by the agent**: An agency may also be terminated by an express renunciation by the agent because a person cannot be compelled to continue as agent against his will. But he must give a reasonable notice of renunciation to the principal, otherwise he will be liable to compensate the principal for any damage resulting thereby (Sec. 206). If the agency is for a fixed period and the agent renounces it without sufficient cause before the expiry of the period, he shall have to compensate the principal for the resulting loss, if any (Sec. 205).

B. Termination by Operation of Law

An agency comes to an end automatically by operation of law in the following cases:

1. **Completion of the business of agency**: An agency automatically comes to an end when the business of agency is completed (Sec. 201). Thus, for example, an agency for the sale of a particular property terminates on the

completion of the sale. Similarly, where a lawyer is appointed to plead in a suit, his authority comes to an end with the judgment.

2. **Expiry of time**: If the agent is appointed for a fixed term, the expiration of the term puts an end to the agency, even though the business of the agency may not have been completed.
3. **Death of the principal or the agent**: An agency is terminated automatically on the death of the principal or the agent (Sec. 201). After coming to know about the principal's death although the agency terminates but the agent must take all reasonable steps for the protection of the interests of the late principal entrusted to him (Sec. 209).
4. **Insanity of the principal or the agent**: An agency also stands terminated when the principal becomes of an unsound mind (Sec. 201). Here also it is the duty of an agent to protect the interests of the former principal by taking all reasonable steps (Sec. 209). Likewise when the agent becomes insane during the agency, his authority terminates at once and the agency comes to an end (Sec. 201). It is interesting to mention that a person of unsound mind can be initially appointed as an agent.
5. **Insolvency of the principal**: An agency is also terminated by the insolvency of the principal (Sec. 201). Whether the insolvency of an agent puts an end to the agency or not is a disputed question, Section 201 is silent on this point.
6. **Destruction of the subject-matter**: An agency which is created to deal with certain subject-matter will be terminated by the destruction of that subject-matter. For example, where the agency was created for the sale of a house and the house is destroyed by fire, the agency ends.
7. **Dissolution of a company**: If the principal or agent is an incorporated company, the agency automatically ceases to exist on dissolution of the company.
8. **Principal or agent becomes alien enemy**: If the principal and agent are nationals of two different countries and a war breaks out between the two countries, the contract of agency is terminated. The outbreak of war renders the continuance of the principal and agent relationship unlawful because now the principal or agent becomes an alien enemy.

3.3.1 When Termination of Agency Takes Effect

As between the principal and the agent, termination of agency is effective only when it becomes known to the agent, and so far as the third parties are concerned termination of agency takes effect when it is made known to them (Sec. 208). For example, in the case of termination of agency by revocation of agent's authority, the agency comes to an end as between the principal and the agent not from the moment of posting the letter of revocation, but from the time the agent receives the letter of revocation. Although after receiving the letter of revocation the agent's

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authority ends but he can still bind the principal towards third parties, if the third parties do not know the fact of the termination of agency. Thus the principal must also give a public notice regarding the fact of the termination of agency in order to make termination effective *vis-a-vis* third parties as well. Even when the agency is terminated automatically by the death, insanity or insolvency of the principal, knowledge of the agent is essential for completing termination as between him and the principal; and knowledge of third party is essential for making termination effective as between the third party and principal.

3.3.2 Irrevocable Agency

When the authority given to an agent cannot be revoked, it is said to be an irrevocable agency. An agency becomes irrevocable in the following cases:

1. **Where the agency is coupled with interest** (Sec. 202): Where the agent has himself an interest in the subject-matter of agency, the agency is said to be coupled with interest. Such an agency is created with the object of protecting or securing any interest of the agent. So where a creditor is employed for valuable consideration as an agent to collect rents due to the principal (debtor) for adjusting the amount towards his debt, the principal thereby confers an interest on the agent and the authority cannot be revoked unilaterally *during the subsistence of the interest*, in the absence of an express contract to the contrary.

   It is important that the doctrine of agency coupled with interest applies only, if the authority was intended for the protection of an interest of the agent *existing at the time of the creation of the agency* and it is not sufficient that it does so incidentally. It, therefore, cannot apply where the interest arises after the creation of the agency.

   It must also be noted that an agency coupled with interest is not terminated even by the death, insanity or insolvency of the principal.

2. **When revocation would cause the agent personal loss**: Where the agent has, in pursuance of his authority, contracted a personal liability, the agency becomes irrevocable and the principal cannot revoke the authority unilaterally. This is so because the principal cannot be permitted to defeat rights already established.

3. **When the authority has been partly exercised by the agent** (Sec. 204): Where the agent has partly exercised his authority, it becomes irrevocable so far as regards such acts and obligations as arise from acts already done in the agency.

Check Your Progress

4. List the various ways of terminating an agency.
5. When does an agency become irrevocable?

3.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. 'An *agent* is a person employed to do any act for another or to represent another in dealings with third persons. The person for whom such act is done, or who is represented, is called the *principal*.'
2. Agency by estoppel is based on the 'doctrine of estoppel' which may briefly be stated thus, 'Where a person by his words or conduct has wilfully led another to believe that certain set of circumstances or facts exists, and that other person has acted on that belief, he is estopped or precluded from denying the truth of such statements, although such a state of things did not in fact exist.'
3. A valid ratification must fulfil the following conditions:
   - (i) The agent must purport to act as agent for a principal who is in contemplation. The agent must expressly contract as an agent for a principal in the knowledge of third parties.
   - (ii) There should be an act capable of ratification. The act to be ratified must be a lawful one. There can be no ratification of an illegal act or an act which is void.
   - (iii) The principal must be in existence. For a valid ratification it is essential that the principal must be in existence at the time when the original contract is made, because rights and obligations cannot attach to a non-existent person.
   - (iv) The principal must be competent to contract. The principal must have contractual capacity both at the time of original contract and at the time of ratification. Thus a person cannot ratify a contract made on his behalf during his minority.
   - (v) The principal must have full knowledge of material facts. Section 198 declares: 'No valid ratification can be made by a person whose knowledge of facts of the case is materially defective.'
4. The various ways of terminating an agency are as follows:
   - (i) By act of the parties
   - (ii) By operation of law
5. When the authority given to an agent cannot be revoked, it is said to be an irrevocable agency. An agency becomes irrevocable in the following cases:
   - (i) Where the agency is coupled with interest (Sec. 202): Where the agent has himself an interest in the subject-matter of agency, the agency is said to be coupled with interest. Such an agency is created with the object of protecting or securing any interest of the agent. It must also be noted that an agency coupled with interest is not terminated even by the death, insanity or insolvency of the principal.

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(ii) When revocation would cause the agent personal loss: Where the agent has, in pursuance of his authority, contracted a personal liability, the agency becomes irrevocable and the principal cannot revoke the authority unilaterally.

(iii) When the authority has been partly exercised by the agent (Sec. 204): Where the agent has partly exercised his authority, it becomes irrevocable so far as regards such acts and obligations as arise from acts already done in the agency.

3.5 SUMMARY

- In a way, an agent is merely a connecting link. After entering into a contract on behalf of the principal with a third party, the agent drops out and ceases to be a party to the contract and the contract binds the principal and the third party as if they have made it themselves.
- Agency exists 'whenever a person has the authority to act on behalf of the other and to create contractual relations between that other and third persons.' When this kind of power is not enjoyed, the relationship is not one of agency.
- According to Section 183, 'any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent.' As such any person competent to contract may employ an agent and a minor, a lunatic or a drunken person cannot employ an agent.
- A special agent is one who is employed to do some particular act or represent his principal in some particular transaction, e.g., an agent employed to sell a motor car.
- Implied agency arises when there is no express agreement appointing a person as an agent, but instead the existence of agency is inferred from the circumstances of the case, or from the conduct of the parties on a particular occasion, or from the relationship between parties (Sec. 187).
- Section 196 deals with the effect of 'ratification.' It provides that 'where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or to disown such acts. If he ratifies them, the same effects will follow as if they had been performed by his authority.'
- An agency may also be terminated by an express renunciation by the agent because a person cannot be compelled to continue as agent against his will. But he must give a reasonable notice of renunciation to the principal, otherwise he will be liable to compensate the principal for any damage resulting thereby (Sec. 206).

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- Even when the agency is terminated automatically by the death, insanity or insolvency of the principal, knowledge of the agent is essential for completing termination as between him and the principal; and knowledge of third party is essential for making termination effective as between the third party and principal.
- It is important that the doctrine of agency coupled with interest applies only, if the authority was intended for the protection of an interest of the agent existing at the time of the creation of the agency and it is not sufficient that it does so incidentally. It, therefore, cannot apply where the interest arises after the creation of the agency.

3.6 KEY WORDS

- **Agent:** It refers to a person employed to do any act for another or to represent another in dealings with third persons.
- **General agent**: One who is employed to do all acts connected with a particular business or employment is a general agent.
- **Special agent:** It means someone who is employed to do some particular act or represents his principal in some particular transaction.
- **Ratification:** Subsequent adoption and acceptance of an act originally done without instructions or authority is known as retaliation.

3.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the general rules of agency.
2. Write in brief about various kinds of mercantile agents.
3. Write in short the main rights of agent.
4. Write a brief note on termination by act of the parties.
5. Write a short note on termination by operation of law.

Long-Answer Questions

1. "An agent is merely a connecting link." Justify this statement.
2. Discuss the legal effects of the appointment of a sub-agent.
3. Analyse some of the rights and duties of an agent.
4. Analyse the various ways of termination of agency.

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3.8 FURTHER READINGS

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UNIT 4 SALE OF GOODS ACT, 1930

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Structure

4.0 INTRODUCTION

The Sale of Goods Act, 1930, which came into force on 1 July 1930, contains the law relating to sale of goods. The Act contains 66 Sections and extends to the whole of India except the State of Jammu and Kashmir. A few minor amendments in the Act were made by the Sale of Goods (Amendment) Act, 1963.

In this unit, you will learn that the general provisions of the Indian Contract Act continue to be applicable to the contract of sale of goods in so far as they are not inconsistent with the express provisions of the Sale of Goods Act. Thus, for example, the provisions of the Contract Act relating to capacity of the parties, free consent, agreements in restraint of trade, wagering agreements and measure of damages continue to be applicable to a contract of sale of goods. But the definition

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of consideration stands modified to the extent that in a contract of sale of goods consideration must be by way of 'price', i.e., only money consideration.

A contract of sale of goods results, like any other contract, by an offer by one party and its acceptance by the other. Thus, you will understand that it is a consensual transaction. The parties to the contract enjoy unfettered discretion to agree to any terms they like relating to delivery and payment of price, etc. The Sale of Goods Act does not seek to fetter this discretion. It simply lays down certain positive rules of general application for those cases where the parties have failed to contemplate expressly for contingencies which may interrupt the smooth performance of a contract of sale, such as the destruction of the thing sold, before it is delivered or the insolvency of the buyer, etc. The Act leaves the parties free to modify the provisions of the law by express stipulations.

4.1 OBJECTIVES

After going through this unit, you will be able to:

- Explain the essentials of a contract of sale of goods
- Describe the conditions and warranties implied in a contract of sale of goods
- Discuss the general rules regarding the transfer of property
- Identify the rules relating to delivery of goods and acceptance of goods
- Understand the concept of an 'unpaid seller' and the remedies available to an 'unpaid seller'

4.2 CONTRACT OF SALE OF GOODS

The law relating to sale of goods is contained in the Sale of Goods Act, 1930, which came into force on 1st July 1930. The Act contains sixty-six Sections and extends to the whole of India except the State of Jammu and Kashmir. A few minor amendments in the Act were made by Sale of Goods (Amendment) Act, 1963.

The general provisions of the Indian Contract Act continue to be applicable to the contract of sale of goods in so far as they are not inconsistent with the express provisions of Sale of Goods Act (Sec. 3). Thus, for example, the provisions of the Contract Act relating to capacity of the parties, free consent, agreements in restraint of trade, wagering agreements and measure of damages continue to be applicable to a contract of sale of goods. But the definition of consideration stands modified to the extent that in a contract of sale of goods consideration must be by way of 'price,' *i.e.,* only money consideration [Secs. 2(10) and 4].

A contract of sale of goods results, like any other contract, by an offer by one party and its acceptance by the other. Thus, it is a consensual transaction. The

parties to the contract enjoy unfettered discretion to agree to any terms they like relating to delivery and payment of price, etc. The Sale of Goods Act does not seek to fetter this discretion. It simply lays down certain positive rules of general application for those cases where the parties have failed to contemplate expressly for contingencies which may interrupt the smooth performance of a contract of sale, such as the destruction of the thing sold, before it is delivered or the insolvency of the buyer, etc. The Act leaves the parties free to modify the provisions of the law by express stipulations.

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4.2.1 Essentials of a Contract of Sale

Section 4(1) of the Sale of Goods Act defines a contract of sale of goods as, "a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price."

This definition reveals the following essential characteristics of a contract of sale of goods:

1. **Two parties**: The first essential is that there must be two distinct parties to a contract of sale, *viz.,* a buyer and a seller, as a person cannot buy his own goods. Thus, for example, when students of a hostel take meals with a mess run by themselves on cooperative lines, there is no contract of sale. The students are 'undivided joint owners' of the meals they are consuming. As a matter of fact every member of the mess is consuming his own goods on the basis of understanding that he must restore to the mess what he consumed so that the mess continue to provide meals for its members. An 'undivided joint owner' must be distinguished from a 'part-owner' who is a joint owner with divisible share. According to Section 4(1), there may be a contract of sale between one part-owner and another, *e.g.,* if *A* and *B* jointly own a computer, *A* may sell his ownership in the computer to *B*, thereby making *B* sole owner of the goods. Similarly, a partner may buy the goods from the firm in which he is a partner and *vice-versa.* There is, however, one exceptional case when a person may buy his own goods. Where a person's goods are sold in execution of a decree, he may himself buy them, so as to save them from a transfer of ownership to someone else (*Moore* vs *Singer Manufacturing Co.*).
2. **Transfer of property**: 'Property' here means 'ownership'. Transfer of property in the goods is another essential of a contract of sale of goods. A mere transfer of possession of the goods cannot be termed as sale. To constitute a contract of sale the seller must either transfer or agree to transfer the property in the goods to the buyer. Further, the term 'property,' as used in the Sale of Goods Act, means 'general property' in goods as distinguished from 'special property' [Sec. 2(11)]. If *P* who owns certain goods pledges them to *R,* he has general property in the goods, whereas *R* (the Pawnee) has special property or interest in the goods to the extent of the amount of

advance he has made to the pawnor. Similarly, in the case of bailment of goods for the purpose of repair, the bailee has special interest in goods bailed to the extent of his labour charges.

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3. **Goods**: The subject-matter of the contract of sale must be 'goods'. According to Section 2(7), '*goods* means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.'

   Thus every kind of movable property except actionable claim and money is regarded as 'goods'. Goodwill, trademarks, copyrights, patent rights, water, gas, electricity, decree of a court of law, are all regarded as goods. Shares and stock are also included in goods. With regard to growing crops, grass and things attached to or forming part of the land, such things are regarded as goods as soon as they are agreed to be separated from the land. Thus where trees were sold so that they could be cut out and separated from the land and then taken away by the buyer, it was held that there was a contract for sale of movable property or goods (*Kursell* vs *Timber Operators & Contractors Ltd.*). But contracts for sale of things 'forming part of the land itself' are not contracts for sale of goods. For example, a contract for the sale of coal mine or building-stone quarry is not a contract of sale of goods.

   'Actionable claims' means claims which can be enforced by a legal action or a suit, *e.g.,* a book debt (*i.e.,* a debt evidenced by an entry by the creditor in his Account Book or *Bahi*). A book debt is not goods because it can only be assigned as per the Transfer of Property Act but cannot be sold. The right of a partner to sue for an account of a dissolved firm is an actionable claim (*Sunrise Associates* vs *Govt. of NCT of Delhi and Others*). Similarly, a bill of exchange or a promissory note represents a debt, *i.e.,* an actionable claim and implies the right of the creditor to recover its amount from the debtor. But since these can be transferred under Negotiable Instruments Act by mere delivery *or* indorsement and delivery, such instruments cannot be sold.

   'Money' means current money. It is not regarded goods because it is the medium of exchange through which goods can be bought. Old and rare coins, however, may be treated as goods and sold as such.

   It may be mentioned that sale of immovable property is governed by the Transfer of Property Act, 1882.

4. **Price**: The consideration for a contract of sale must be money consideration called the 'price.' If goods are sold or exchanged for other goods, the transaction is barter, governed by the Transfer of Property Act and not a sale of goods under this Act. But if goods are sold partly for goods and partly for money, the contract is one of sale (*Aldridge* vs *Johnson*).

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5. **Includes both a 'sale' and 'an agreement to sell.'** The term 'contract of sale' is a generic term and includes both a 'sale' and an 'agreement to sell' [as is clear from the definition of the term as per Section 4(1) given earlier].

   Sale: Where under a contract of sale the property in the goods is immediately transferred at the time of making the contract from the seller to the buyer, the contract is called a 'sale' [Sec. 4(3)]. It refers to an 'absolute sale', *e.g.,* an outright sale on a counter in a shop. There is immediate conveyance of the ownership and mostly of the subject-matter of the sale as well (delivery may also be given in future). It is an *executed* contract.

   An agreement to sell: Where under a contract of sale the transfer of property in the goods is to take place at a future time or subject to some condition thereafter to be fulfilled, the contract is called 'an agreement to sell' [Sec. 4(3)]. It is an *executory* contract and refers to a conditional sale.

   'An agreement to sell' becomes a 'sale' when the time elapses or the conditions are fulfilled subject to which the property in the goods is to be transferred [Sec. 4 (4)].

6. **No formalities to be observed** (Sec. 5). The Sale of Goods Act does not prescribe any particular form to constitute a valid contract of sale. A contract of sale of goods can be made by mere offer and acceptance. The offer may be made either by the seller or the buyer and the same must be accepted by the other. Neither payment nor delivery is necessary at the time of making the contract of sale. Further, such a contract may be made either orally or in writing or partly orally and partly in writing or may be even implied from the conduct of the parties. Where articles are exhibited for sale and a customer picks up one and the sales assistant packs the same for him, there has resulted a contract of sale of goods by the conduct of the parties.

It is essential to clearly understand the distinction between sale and agreement to sell, sale and hire purchase, hire purchase and agreement to sell, and sale and contract for work and labour. These are as follows:

A. Distinction between 'Sale' and 'Agreement to Sell'

The following are the main points of distinction between a 'sale' and 'an agreement to sell':

1. **Transfer of property (ownership)**: In a 'sale', the property in goods passes to the buyer immediately at the time of making the contract. In other words, a sale implies immediate conveyance of property so that the seller ceases to be the owner of the goods and the buyer becomes the owner thereof. It creates *a jus in rem, i.e.,* gives right to the buyer to enjoy goods as against the whole world.

   In 'an agreement to sell' there is no transfer of property to the buyer at the time of the contract. The conveyance of property takes place later so that the seller continues to be the owner until the agreement to sell becomes a

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sale either by the expiry of certain time or the fulfilment of some condition. Thus where *A* agrees to buy 50 kg wheat from *B* and the wheat is yet to be weighed, the transaction is an agreement to sell because as per Section 22, in such a case the property does not pass to the buyer till the goods are weighed and the buyer has notice thereof. The transaction becomes a sale and the property in the goods passes to the buyer after the wheat is weighed and the buyer has notice thereof. An agreement to sell creates a *jus in personam,* that is, it gives a right to either buyer or seller against the other for any default in fulfilling his part of the agreement.

It is worth noting that this is the basic point of distinction between a 'sale' and 'an agreement to sell.' All other points of distinction follow from this basic difference, *i.e.,* whether the property in the goods has passed or is yet to pass from seller to buyer.

2. **Risk of loss**: The general rule is that unless otherwise agreed, the risk of loss *prima facie* passes with property (Sec. 26). Thus in case of sale, if the goods are destroyed the loss falls on the buyer even though the goods may never have come into his possession because the property in the goods has already passed to the buyer. On the other hand, in case of an agreement to sell where the ownership in the goods is yet to pass from the seller to the buyer, such loss has to be borne by the seller even though the goods are in the possession of the buyer,
3. **Consequences of breach**: In case of sale, if the buyer wrongfully neglects or refuses to pay the price of the goods, the seller can sue for the price, even though the goods are still in his possession. In case of an agreement to sell, if the buyer breaks his promise, the seller can only sue for damages and not for the price, even though the goods are in the possession of buyer.
4. **Right of resale**: In a sale, the property is with the buyer and as such the seller (in possession of goods after sale) cannot resell the goods. If he does so, the subsequent buyer having knowledge of the previous sale does not acquire a title to the goods. The original buyer can sue and recover the goods from the third person as owner, and can also sue the seller for the breach of contract as well as for the tort of conversion. The right to recover the goods from the third person is, however, lost if the subsequent buyer had bought them *bona fide* without notice of the previous sale (Sec. 30).

   In an agreement to sell, the property in the goods remains with the seller and as such he can dispose of the goods as he likes and the original buyer can sue him for the breach of contract only. In this case, the subsequent buyer gets a good title to the goods, irrespective of his knowledge of previous sale. Further, goods forming the subject-matter of an agreement to sell can also be attached in execution of a decree of a court of law against the seller.
5. **Insolvency of buyer before he pays for the goods**: In a sale, if the buyer is adjudged insolvent before he pays for the goods, the seller, in the

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absence of a 'right of lien' over the goods, must deliver the goods to the Official Receiver or Assignee. The seller is entitled only to a rateable dividend for the price of the goods. But in an agreement to sell, in these circumstances, the seller may refuse to deliver the goods to the Official Receiver or Assignee unless paid for, as ownership has not passed to the buyer.

6. **Insolvency of seller if the buyer has already paid the price**: In a sale, if the seller is adjudged insolvent, the buyer is entitled to recover the goods from the Official Receiver or Assignee, as the property in the goods rests with the buyer. On the other hand, in an agreement to sell, if the buyer has already paid the price and the seller is adjudged insolvent, the buyer can only claim a rateable dividend (as a creditor) and not the goods because property in them still rests with the seller.

B. Distinction between Sale and Hire Purchase

Contracts of sale resemble contracts of hire purchase very closely, and indeed the real object of a contract of hire purchase is the sale of the goods ultimately. Nonetheless, a sale has to be distinguished from a hire purchase as their legal incidents are quite different. Under hire purchase agreement the goods are delivered to the hire purchaser for his use at the time of the agreement but the owner of the goods agrees to transfer the property in the goods to the hire purchaser only when a certain fixed number of instalments of price are paid by the hirer. Till that time, the hirer remains the bailee and the instalments paid by him are regarded as the hire-charges for the use of the goods. If there is a default by the hire purchaser in paying an instalment, the owner has a right to resume the possession of the goods immediately without refunding the amount received till then, because the ownership still rests with him. Thus, the essence of hire-purchase agreement is that there is no agreement to buy, but there is only a bailment of the goods coupled with an option to purchase them which may or may not be exercised.

It may be noted that mere payment of price by instalments under an agreement does not necessarily make it a hire-purchase, but it may be a sale. For example, in the case of 'Instalment Purchase Method,' there is a 'sale,' because in this case the buyer is bound to buy with no option to return and the property in goods passes to the buyer at once.

The main points of distinction between the 'sale' and 'hire-purchase' are as follows:

1. In a sale, property in the goods is transferred to the buyer immediately at the time of contract, whereas in hire-purchase the property in the goods passes to the hirer upon payment of the last instalment.
2. In a sale the position of the buyer is that of the owner of the goods but in hire purchase the position of the hirer is that of a bailee till he pays the last instalment.

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3. In the case of a sale, the buyer cannot terminate the contract and is bound to pay the price of the goods. On the other hand, in the case of hire-purchase the hirer may, if he so likes, terminate the contract by returning the goods to its owner without any liability to pay the remaining instalments.
4. In the case of a sale, the seller takes the risk of any loss resulting from the insolvency of the buyer. In the case of hire purchase, the owner takes no such risk, for if the hirer fails to pay an instalment the owner has the right to take back the goods.
5. In the case of a sale, the buyer can pass a good title to a *bona fide* purchaser from him but in a hire-purchase, the hirer cannot pass any title even to a *bona fide* purchaser.
6. In a sale, sales tax is levied at the time of the contract whereas in a hire-purchase sales tax is not leviable until it eventually ripens into a sale (*K. L. Johar & Co.* vs *Dy. Commercial Tax Officer*).

C. Hire-purchase and an agreement to sell

A contract of hire-purchase may also be distinguished from 'an agreement to sell' (or 'an agreement to buy' from buyer's point of view). As already observed, a hire-purchase agreement initially is merely an *irrevocable offer* for sale, that is, under it the owner is bound to sell the goods later if the hirer pays all the instalments as agreed, but on the part of the hire purchaser there is an option to buy or to return the goods and the hirer cannot be compelled to buy. 'An agreement to buy', on the other hand, imports a legal obligation to buy and therefore there is no option available to the buyer to buy or to terminate the contract in this case. Again, in a hire-purchase agreement, delivery of goods to the hire-purchaser is necessary whereas it is not so in an 'agreement to sell.'

D. Distinction between Sale and Contract for Work and Labour

A distinction has to be made between a contract of sale and a contract for work and labour mainly because of taxation purpose. Sales tax is levied only in the case of a contract of sale. When property in the goods is intended to be transferred and goods are ultimately to be delivered to the buyer, it is a contract of sale even though some labour on the part of the seller of the goods may be necessary. Where, however, the essence of the contract is rendering of service and exercise of skill and no goods are delivered as such, it is a contract of work and labour and not of sale. In fact, the difference between the two is very minute.

4.2.2 Kinds of Goods

'Goods' form the subject-matter of a contract of sale. We have already seen the meaning of the term 'goods' as per Section 2(7). Goods may be classified into the following types:

1. Existing goods;

2. Future goods; and
3. Contingent goods.

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1. **Existing goods**: Goods which are physically in existence and which are in seller's ownership and/or possession, at the time of entering the contract of sale, are called 'existing goods.' Where seller is the owner, he has the general property in them. Where seller is in possession, say, as an agent or a pledgee, he has a right to sell them.

   Existing goods may again be either 'specific' or 'unascertained.'

   (a) Specific goods: Goods identified and agreed upon at the time of the making of the contract of sale are called 'specific goods' [Sec. 2(14)]. It may be noted that in actual practice the term 'ascertained goods' is used in the same sense as 'specific goods.' For example, where *A* agrees to sell to *B* a particular DVD player bearing a distinctive number, there is a contract of sale of specific or ascertained goods.

   (b) Unascertained goods: The goods which are not separately identified or ascertained at the time of the making of the contract are known as 'unascertained goods.' They are indicated or defined only by description. For example, if *A* agrees to sell to *B* one bag of sugar out of the lot of one hundred bags lying in his godown, it is a sale of unascertained goods because it is not known which bag is to be delivered. As soon as a particular bag is separated from the lot for delivery, it becomes ascertained or specific goods.

   The distinction between 'specific' or 'ascertained' and 'unascertained' goods is important in connection with the rules regarding 'transfer of property' from the seller to the buyer. These rules will be discussed later in Chapter 18—*Transfer of Property*.

2. **Future goods**: Goods to be manufactured, produced or acquired by the seller after the making of the contract of sale are called 'future goods' [Sec. 2(6)]. These goods may be either not yet in existence or be in existence but not yet acquired by the seller. It is worth noting that there can be no present sale of future goods because property cannot pass in what is not owned by the seller at the time of the contract. So even if the parties purport to effect a present sale of future goods, in law it operates only as an 'agreement to sell' [Sec. 6(3)].

3. **Contingent goods**: Goods, the acquisition of which by the seller depends upon an uncertain contingency are called 'contingent goods' [Sec. 6(2)]. Obviously they are a type of future goods and therefore a contract for the sale of contingent goods also operates as 'an agreement to sell' and not a 'sale' so far as the question of passing of property to the buyer is concerned. In other words, like the future goods, in the case of contingent goods also the property does not pass to the buyer at the time of making the contract. It is important to note that a contract of sale of contingent goods is

enforceable only if the event on the happening of which the performance of the contract is dependent happens, otherwise the contract become void.

4.2.3 Effect of Perishing of Goods

Sections 7 and 8 deal with the effect of perishing of goods on the rights and obligations of the parties to a contract of sale. Under these Sections the word 'perishing' means not only physical destruction of the goods but it also covers:

(*a*) Damage to goods so that the goods have ceased to exist in the commercial sense, *i.e.*, their merchantable character as such has been lost (although they are not physically destroyed), *e.g.*, where cement is spoiled by water and becomes almost stone or where sugar becomes *sharbat* and thus are unsaleable as cement or sugar;

(*b*) Loss of goods by theft (*Barrow Ltd.* vs *Phillips Ltd.*);

(*c*) Where the goods have been lawfully requisitioned by the government (*Re Shipton, Anderson & Co.*).

It may also be mentioned that it is only the perishing of *specific and ascertained goods* that affects a contract of sale. Where, therefore, *unascertained goods* form the subject-matter of a contract of sale, their perishing does not affect the contract and the seller is bound to supply the goods from wherever he likes, otherwise be liable for breach of contract. Thus where *A* agrees to sell to *B* ten bales of Egyptian cotton out of 100 bales lying in his godown and the bales in the godown are completely destroyed by fire, the contract does not become void. *A* must supply ten bales of cotton after purchasing them from the market or pay damages for the breach.

The effect of perishing of goods may be discussed under the following heads:

1. **Perishing of specific goods at or before making of the contract** (Sec. 7). This may again be divided into the following sub-heads:

   (*i*) *In case of perishing of the 'whole' of the goods:* Where *specific goods* form the subject-matter of a contract of sale (both actual sale and agreement to sell), and they, without the knowledge of the seller, perish, at or before the time of the contract, the agreement is void. This provision is based either on the ground of mutual mistake as to a matter of fact essential to the agreement, or on the ground of impossibility of performance, both of which render an agreement void *ab-initio.*

   (*ii*) *In case of perishing of only 'a part' of the goods:* Where in a contract for the sale of *specific goods,* only *part* of the goods are destroyed or damaged, the effect of perishing will depend upon whether the contract is entire or divisible. If it is entire (*i.e.,* indivisible) and part only of the goods has perished, the contract is void. If the contract is divisible, it will not be void and the part available in good condition must be accepted by the buyer.

2. **Perishing of specific goods before sale but after agreement to sell** (Sec. 8). Where there is an agreement to sell specific goods, and subsequently the goods, without any fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is thereby avoided, *i.e.*, the contract of sale becomes void, and both parties are excused from performance of the contract. This provision is based on the ground of supervening impossibility of performance which makes a contract void. Notice that under Section 7 the agreement is void *ab-initio* while under this Section the contract becomes void later.

If only *part* of the goods agreed to be sold perish, the contract becomes void if it is indivisible. But if it is divisible then the parties are absolved from their obligations only to the extent of the perishing of the goods (*i.e.*, the contract remains valid as regards the part available in good condition).

It must further be noted that if fault of either party causes the destruction of the goods, then the party in default is liable for non-delivery or to pay for the goods, as the case may be (Sec. 26). Again, if the risk has passed to the buyer, he must pay for the goods, though undelivered [unless otherwise agreed ... risk *prima facie* passes with the property (Sec. 26)].

Effect of perishing of future goods*:* As observed earlier, a present sale of future goods always operates as an agreement to sell [Sec. 6(3)]. As such there arises a question as to whether Section 8 applies to a contract of sale of future goods (amounting to an agreement to sell) as well? The answer is found in the leading case of *Howell* vs *Coupland,* where it has been held that future goods, if sufficiently identified, are to be treated as specific goods, the destruction of which makes the contract void. The facts of the case are as follows:

4.2.4 The Price and its Mode of Fixing

The money consideration for a sale of goods is known as 'price' [Sec. 2(10)]. We have already seen that the price is an essential element in every contract of sale of goods, that is, no valid sale can take place without a price. The price should be paid or promised to be paid in legal tender money, unless otherwise agreed. It may be paid in the form of a cheque, hundi, bank deposit, etc. For, it is not the mode of payment of a price but the agreement to pay a price in money that is requisite to constitute a valid contract of sale. Some important aspects of the price are:

A. Modes of fixing the price

According to Section 9 the price may be fixed by one or the other of the following modes:

1. *It may be expressly fixed by the contract itself*. This is the most usual mode of fixing the price. The parties are free to fix any price they like and the court will not question as to the adequacy of price. But the sum should be definite. Where an alternative price is fixed, the agreement is void *ab-*

initio as it involves an element of wager (*Bourke* vs *Short*). Thus, where *A* agrees to sell his cow to *B* for ₹ 5,000 if the cow gives 10 kg milk every day but for ₹ 100 only if it fails to do so, there is a wagering agreement void *ab-initio*.

2. *It may be fixed in accordance with an agreed manner provided by the contract*. For example, it may be agreed that the buyer would pay the market price prevailing on a particular date, or that the price is to be fixed by a third party (*i.e.,* valuer) appointed by the consent of the parties. But in the following cases where the agreement of the parties as to price is uncertain, price is deemed as 'not capable of being fixed' and hence the agreement is void *ab-initio* for uncertainty:
   (*a*) If the price is agreed to be whatever sum the seller be offered by any third party; or
   (*b*) If the price is left to be fixed by one of the contracting parties, expressly.

   Remember that if no price is fixed then the contract is not void for uncertainty because in that case law usually allows market price prevailing on the date of the supply of goods as the price bargained for.
3. *It may be determined by the course of dealings between the parties*. For example, if the buyer has been previously paying to a particular seller the price prevailing on the date of placing the order, the course of dealings suggest that in subsequent transactions also the price as on the date of order will be paid.
4. *If the price is not capable of being determined in accordance with any of the above modes, the buyer is bound to pay to the seller a 'reasonable price.'* What is a reasonable price is a question of fact dependent on the circumstances of each particular case. Ordinarily, the market price of the goods prevailing on the date of supply is taken as reasonable price.

B. Agreement to sell at valuation (Sec. 10)

Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party fails to fix the price (either because he cannot value or because he does not want to value), the contract becomes void, except as to part of goods delivered and accepted, if any, under the contract, as regards which the buyer is bound to pay a reasonable price. If, however, any one of the two parties, namely, the seller or the buyer, prevents the third party from making the valuation, the innocent party may maintain a suit for damages against the party in fault. Notice that although in this case also the contract becomes void, yet the party at fault is bound to compensate the other party for the actual loss suffered by him because of the act of prevention.

It is to be remembered that unless otherwise agreed, payment of the price and delivery of the goods are concurrent conditions (Sec. 32). Again, Section 64-A, which provides for 'Escalation Clause,' is important. As per Section 64-A,

unless otherwise agreed, where, after making of the contract and fixing the price but before the delivery of the goods, a new or increased custom or excise duty or sale or purchase tax is imposed and the seller has to pay it, the seller is entitled to add the same to the price. Conversely, if the rate of duty or tax is lowered, the buyer would be entitled to a reduction in price.

C. Earnest or Deposit

Money deposited with the seller by the buyer as security for due fulfilment of the contract is called 'earnest' or 'deposit'. Where the contract is carried through, earnest money counts as part payment and only the balance of the price is required to be paid. But if the contract goes off because of the fault of the buyer, the seller is entitled to forfeit it and where it falls through because of the default of the seller, the buyer is entitled to recover the earnest money in addition to damages for breach. If on the breach of the agreement by the buyer, the seller sues him for the breach, the earnest, although forfeited, is to be taken into account as diminishing the amount of damages (*Jaganadhayya* vs *Ramanatha*).

D. Stipulations as to Time

Stipulations as to time in a contract of sale fall under the following two heads:

1. Stipulation relating to time of delivery of goods.
2. Stipulation relating to time of payment of the price.

As regards the time fixed for the delivery of goods, time is usually held 'to be of the essence of the contract.' Thus if time is fixed for the delivery of goods and the seller makes a delay, the contract is voidable at the option of the buyer. In case of late delivery, therefore, the buyer may refuse to accept the delivery and may put an end to the contract.

As regards the time fixed for the payment of the price, the general rule is that 'time is not deemed to be of the essence of the contract,' unless a different intention appears from the terms of the contract (Sec. 11). Thus even if the price is not paid as agreed, the seller cannot avoid the contract on that account. He has to deliver the goods if the buyer tenders the price within reasonable time before resale of the goods. The seller may, however, claim compensation for the loss occasioned to him by the buyer's failure to pay on the appointed day.

4.2.5 Document of Title to Goods

Any document which is used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented is a document of title to goods [Sec. 2(4)]. Thus a document of title is a proof of the ownership of the goods. It authorises its holder to receive goods mentioned therein or to further transfer such right to another person by proper endorsement or delivery.

NOTES

A document of title to goods contains an undertaking on the part of the issuing authority to deliver the goods to the holder thereof unconditionally. Although such a document can be transferred by mere delivery or by endorsement, yet it is regarded as 'quasi negotiable instrument' because the title of the transferee (even if *bonafide*) will not be superior to that of the transferor in the case of transfer of such document.

Bill of lading, dock-warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, delivery order, *etc.,* are popular examples of the documents of title to goods.

Check Your Progress

1. What are the various types of goods?
2. What is 'price'?
3. What are the various modes of fixing price?

4.3 CONDITIONS AND WARRANTIES

A contract of sale of goods contains various terms or stipulations regarding the quality of the goods, the price and the mode of its payment, the delivery of goods and its time and place. But all of them are not of equal importance. Some of these stipulations may be *major terms* which go to the very root of the contract and their breach may frustrate the very purpose of the contract, while others may be *minor terms* which are not so vital that their breach may seem to be a breach of the contract as such. In law of sales major terms are called 'conditions' and minor terms are called 'warranties'.

From terms of the contract, it is necessary to distinguish mere statements of commendation or praise or expressions of opinion made by the seller in reference to his goods. Such commendatory statements are neither 'conditions' nor 'warranties'. They do not form a part of the contract and as a result give no right of action. For example, where a horse dealer, while praising his horse, states that the horse is very lucky and one whosoever shall purchase it must very soon become a millionaire, his statement, being mere commendatory in nature, does not form a part of the contract and its breach (*i.e.*, if the buyer of the horse does not actually become a millionaire later) does not give rise to any legal consequences.

A 'condition' is essential to the main purpose of the contract, the breach of which gives the aggrieved party a right to repudiate the contract itself [Sec. 12(2)]. In addition, he may maintain an action for damages for loss suffered, if any, on the footing that the whole contract is broken and the seller is guilty of non-delivery (*Miller's Machinery Co. Ltd.* vs *David Way & Son*).

A 'warranty' is a stipulation *collateral* to the main purpose of the contract, the breach of which gives the aggrieved party a right to sue for damages only, and not to avoid the contract itself. [Sec. 12(3)]

It will be seen that the above definitions explain both the meaning and the legal effect of a 'condition' and a 'warranty'. Accordingly, a 'condition' forms the very basis of a contract of sale, the breach of which causes irreparable damage to the aggrieved party so as to entitle him even to repudiate the contract, whereas a 'warranty' is only of secondary importance, the breach of which causes only such damage as can be compensated for by damages. In fact a breach of 'condition' is followed by the same consequence as the breach of a 'condition precedent' in other contracts; namely, the innocent party has a right to rescind the contract, and claim damages.

There is no hard and fast rule as to which stipulation is a condition and which one is a warranty. Section 12(4) lays down to the same effect, thus, 'whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition though called a warranty in the contract.' Thus the court is not to be guided by the terminology of the parties but has to look to the intention of the parties by referring to the terms of the contract, its construction and the surrounding circumstances to judge whether a stipulation was a condition or a warranty. The most suitable test to distinguish between the two terms is that if the stipulation is such that its breach would be fatal to the rights of the aggrieved party, then such a stipulation is a condition and where it is not so, the stipulation is only a warranty.

But if *P* says to *R*, 'I want a good horse.' *R* shows him a horse and says, 'This is a good horse and it can run at a speed of 30 kilometers per hour,' and *P* buys the horse and finds later on that it can run at a speed of 20 kilometers per hour only, there is a breach of warranty because the stipulation made by the seller did not form the very basis of the contract and was only subsidiary one. The seller gave the assurance about the running speed of the horse of his own without being asked by the buyer hence it is only of secondary importance.

The above illustrations are a clear proof of the fact that an exactly similar term may be a condition in one contract and a warranty in another depending upon the construction of the contract as a whole.

4.3.1 Distinction between Condition and Warranty

The points of distinction between a condition and a warranty may be summed up as under:

1. **As to value**: A condition is a stipulation which is essential to the main purpose of the contract, whereas a warranty is a stipulation which is collateral to the main purpose of the contract. [Sec. 12(2)(3)].

2. **As to breach**: The breach of a condition gives the aggrieved party the right to repudiate the contract and also to claim damages, whereas the breach of warranty gives the aggrieved party a right to claim damages only.
3. **As to treatment:** A breach of condition may be treated as a breach of warranty. But a breach of warranty cannot be treated as a breach of condition.

Section 13 deals with cases where a breach of condition is to be treated as a breach of warranty, as a consequence of which the buyer loses his right to rescind the contract and has to be content with a claim for damages only. These cases are as follows:

1. **Voluntary waiver by buyer**: Although on a breach of condition by the seller, the buyer has a right to treat the contract as repudiated and reject the goods, but he is not bound to do so. He may instead elect to waive the condition, *i.e.,* to treat the breach of condition as a breach of warranty and accept the goods and sue the seller for damages for breach of warranty.
2. **Acceptance of goods by buyer:** Where the buyer has *accepted* the goods and subsequently he comes to know of the breach of condition, he cannot reject them, but can only maintain an action for damages. This case does not depend upon the will of the buyer but the law compulsorily treats a breach of condition as a breach of warranty.

Acceptance of only part of the goods. If the buyer has accepted only part of the goods and the contract is *indivisible,* he will have to treat the breach of condition as a breach of warranty and accept the remaining part also. But in case of *divisible* contracts, he can repudiate as regards remaining goods, if he has accepted only part thereof. Indivisible contracts are those where price for a lot, consisting goods of different qualities, as such is fixed and not fixed per unit or per bag or per ton, *etc*.

Meaning of 'acceptance'. Taking possession or delivery of the goods does not by itself amount to acceptance. According to Section 42, the buyer is deemed to have accepted the goods:

(*i*) when he intimates to the seller that he has accepted them; or

(*ii*) when he does any act in relation to goods which is inconsistent with the ownership of the seller, *e.g*., consumes, uses, pledges or resells the goods or puts his mark on them, *etc*., or

(*iii*) when, after the lapse of reasonable time, he retains the goods without intimating the seller that he has rejected them. On rejection of goods, however, mere informing the seller is enough and the buyer is not bound to return the rejected goods actually (Sec. 43).

4.3.2 Express or Implied Conditions and Warranties

Conditions and warranties may be either express or implied. They are said to be express when at the will of the parties they are inserted in the contract, and they

are said to be implied when the law presumes their existence in the contract automatically though they have not been put into it in express words. Implied conditions and warranties may, however, be negative or varied by express agreement, or by course of dealing between the parties, or by usage of trade (Sec. 62). This provision is merely an application of the general maxim of law, 'what is expressly done puts an end to what is tacit or implied,' and 'custom and agreement over-rule implied conditions and warranties.'

A. Implied Conditions

Unless otherwise agreed, the law incorporates into a contract of sale of goods the following implied conditions:

1. **Condition as to title** [Sec. 14 (*a*)]: In every contract of sale, the first implied condition on the part of the seller is that, in the case of a sale, he has the right to sell the goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass. Ordinarily the seller has the right to sell the goods if either he is the owner of the goods or he is owner's agent. As a result of this condition, if the seller's title turns out to be defective the buyer is entitled to reject the goods and to recover his price. Notice that in the case of breach of condition as to title the buyer has no option to treat the breach of condition as breach of warranty and accept the goods and sue the seller for damages. In this case he must return the goods to the true owner. He can of course recover the price from the seller because of a total failure of consideration.

   It may be noted that the implied condition as to title makes it obligatory upon the seller that he must not only be the owner but also must be able to uphold the validity of the contract. Thus if the goods sold bear labels infringing the trade mark of another, the seller is guilty of breach of this condition although he had full ownership of the goods.

   It may further be noted that 'where a seller having no title to the goods at the time of the sale, subsequently acquires the title (*e.g.*, by paying off the true owner) *before the buyer seeks to repudiate the contract*, that title feeds the defective titles of both the original and subsequent buyers and it will then be too late for the buyer to repudiate the contract (*Patten* vs *Thomas Motors*).

2. **Condition in a sale by description**: 'Where there is a contract of sale of goods by description, there is an implied condition that the goods shall correspond with the description....." (Sec. 15). Lord Blackburn observed: 'If you contract to sell peas, you cannot oblige a party to take beans. If the description of the article tendered is different in any respect, it is not the article bargained for, and the other party is not bound to take it.' It is important that the goods must correspond with the description whether it is a sale of specific goods or of unascertained goods. Further, the fact that the buyer has examined the goods will not affect his right to reject the goods, if the

deviation of the goods from the description is such which could not have been discovered by casual examination, *i.e.,* if the goods show any latent defects.

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The description may be in terms of the qualities or characteristics of the goods, *e.g.*, long staple cotton, Kalyan wheat, sugar C-30, basmati rice or may simply mention the trade mark, brand name or the type of packing, *etc.*

3. **Condition in a sale by sample** (Sec. 17): When under a contract of sale, goods are to be supplied according to a sample agreed upon, the implied conditions are:
   (*i*) that the bulk shall correspond with the sample in quality;
   (*ii*) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;
   (*iii*) that the goods shall be free from any defect, rendering them unmerchantable, which would not be apparent on reasonable examination of the sample. In other words, there should not be any latent defect in the goods. If the defect is patent one, that is, easily discoverable by the exercise of ordinary care, and the buyer takes delivery after inspection, there is no breach of implied condition and the buyer has no remedy.
4. **Condition in a sale by sample as well as by description** (Sec. 15): When goods are sold by sample as well as by description, there is an implied condition that the bulk of the goods shall correspond both with the sample and with the description. If the goods supplied correspond only with the sample and not with the description or *vice versa*, the buyer is entitled to reject the goods. The bulk of the goods must correspond with both.
5. **Condition as to fitness or quality** [Sec. 16 (1)]: Ordinarily, in a contract of sale there is no implied condition or warranty as to quality or fitness for any particular purpose of goods supplied; the rule of law being '*Caveat Emptor*', that is, let the buyer beware. But an implied condition is deemed to exist on the part of the seller that the goods supplied shall be reasonably fit for the purpose for which the buyer wants them, if the following conditions are satisfied:
   (*i*) The buyer, expressly or impliedly, should make known to the seller the particular purpose for which the goods are required;
   (*ii*) The buyer should rely on the seller's skill or judgement; and
   (*iii*) The goods sold must be of a description which the seller deals in the ordinary course of his business, whether he be the manufacturer or not.

   The purpose must be made known expressly if the goods to be supplied can be used for several purposes, otherwise the condition as to fitness will

not be implied and the buyer will have no right to reject the goods merely because they are unfit for the specific purpose he had in mind.

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The purpose need not be told expressly if the goods are fit for one particular purpose only or if the nature of the goods itself tells the purpose by implication. In such cases the purpose is deemed to be made known to the seller impliedly.

Sometimes the implied purpose may also be gathered from usage of the trade, *e.g.*, mobiloil for a scooter implies 'two T's mobiloil.'

It is important that the implied condition applies only in the case of sale of goods to a normal buyer. If the buyer is suffering from an abnormality; say, is allergic to particular foods, medicines, dust, etc., and it is not made known to the seller at the time of sale, this condition does not apply.

Sale under patent or trade name: Proviso to Section 16 (1) lays down that in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose. It is so because in such a case the buyer is not relying on the skill and judgement of the seller but relies on the good reputation that the goods came to acquire and buys them on the strength of that reputation. The seller's duty is to supply the goods of the same trade name as demanded by the buyer, whether they are fit for any particular purpose or not, is not his concern.

But the condition as to fitness will apply if the buyer relies on the seller's skill and judgement as regards the suitability of the goods for a particular named purpose and makes known to the seller that he so relies on him, even though the article is described in the order by its trade name.

6. **Condition as to merchantability** [Sec. 16(2)]: This condition is implied only where the sale is by description. We have already seen that there is an implied condition in such cases, as per Section 15, that the goods should correspond with the description. This sub-section lays down another implied condition in such cases, that is, that the goods should be of 'merchantable quality.' But for making this condition applicable, not only that the sale must be by description, but the following conditions must also be satisfied:
   (*i*) The seller should be a dealer in goods of that description, whether he be the manufacturer or not; and
   (*ii*) The buyer must not have any opportunity of examining the goods or there must be some latent defect in the goods which would not be apparent on reasonable examination of the same.

If the buyer had an opportunity of making the examination but he avoids to examine, or if he has examined the goods, there is no implied condition as to merchantability as regards defects which such examination ought to have revealed [Proviso to Sec. 16(2)].

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The phrase 'merchantable quality' means that the goods are of such quality and in such condition that a reasonable man, acting reasonably, would accept them under the circumstances of the case in performance of his offer to buy those goods, whether he buys them for his own use or to sell again (*S.S. Mendse* vs *Balkrishna Chettiar*). Stated briefly, in order to be 'merchantable' the goods must be such as are reasonably saleable under the description by which they are known in the market.

7. **Condition as to wholesomeness**: This condition is implied only in a contract of sale of eatables and provisions. In such cases the goods supplied must not only answer to description and be merchantable but must also be wholesome, *i.e.*, free from any defect which render them unfit for human consumption.

B. Implied Warranties

Unless otherwise agreed, the law also incorporates into a contract of sale of goods the following implied warranties:

1. **Warranty of quiet possession** [Sec. 14(*b*)]: In every contract of sale, the first implied warranty on the part of the seller is that 'the buyer shall have and enjoy quiet possession of the goods.' If the quiet possession of the buyer is in any way disturbed by a person having a superior right than that of the seller, the buyer can claim damages from the seller. Since disturbance of quiet possession is likely to arise only where the seller's title to goods is defective, this warranty may be regarded as an extension of the implied condition of title provided for by Section 14(*a*). In fact the two clauses of Section 14 [*i.e.*, (*a*) and (*b*)] are overlapping and it is not easy to see what additional rights this warranty confers on the buyer over and above those conferred by the implied condition as to title contained in Section 14(*a*).
2. **Warranty of freedom from encumbrances** [Sec. 14(*c*)]: The second implied warranty on the part of the seller is that 'the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made.' If the goods are afterwards found to be subject to a charge and the buyer has to discharge the same, there is breach of warranty and the buyer is entitled to damages. It is to be emphasised that the breach of this warranty occurs only when the buyer in fact discharges the amount of the encumbrance, and he had no notice of that at the time of the contract of sale. If the buyer knows about the encumbrance on the goods at the time of entering into the contract, he becomes bound by the same and he is not entitled to claim compensation from the seller for discharging the same.
3. **Warranty of disclosing the dangerous nature of goods to the ignorant buyer**: The third implied warranty on the part of the seller is that in case the goods sold are of dangerous nature he will warn the ignorant buyer of the

probable danger. If there is breach of this warranty the buyer is entitled to claim compensation for the injury caused to him. Romer L.J. observed, 'I think that, apart from any question of warranty, there is a duty cast upon a vendor, who knows of the dangerous character of goods which he is supplying, and also knows that the purchaser is not, or may not be, aware of it, not to supply the goods without giving some warning to the purchaser of that danger."

4.3.3 Doctrine of *Caveat Emptor*

The maxim of *caveat emptor* means 'let the buyer beware.' According to the doctrine of *caveat emptor,* it is the duty of the buyer to be careful while purchasing goods of his requirement and, in the absence of any enquiry from the buyer, the seller is not bound to disclose every defect in goods of which he may be cognisant. The buyer must examine the goods thoroughly and must see that the goods he buys are suitable for the purpose for which he wants them. If the goods turn out to be defective or do not suit his purpose, the buyer cannot hold the seller liable for the same, as there is no implied undertaking by the seller that he shall supply such goods as suit the buyer's purpose. If, therefore, while making purchases of goods the buyer depends upon his own skill and makes a bad choice, he must curse himself for his own folly, in the absence of any misrepresentation or fraud or guarantee by the seller.

However, the doctrine of *caveat emptor* is subject to the following exceptions:

1. Where the seller makes a *mis-representation* and the buyer relies on it, the doctrine of *caveat emptor* does not apply. Such a contract being voidable at the option of the innocent party, the buyer has a right to rescind the contract.
2. Where the seller makes a false representation amounting to *fraud* and the buyer relies on it, or where the seller actively conceals a defect in the goods so that the same could not be discovered on a reasonable examination, the doctrine of *caveat emptor* does not apply. Such a contract is also voidable at the option of the buyer and the buyer is entitled to avoid the contract and also claim damages for fraud.
3. Where the goods are purchased by description and they do not correspond with the description (Sec. 15). (*See* implied condition 'in a sale by description' discussed earlier).
4. Where the goods are purchased by description from a seller who deals in such class of goods and they are not of 'merchantable quality', the doctrine of *caveat emptor* does not apply. But the doctrine applies, if the buyer has examined the goods, as regards defects which such examination ought to have revealed [Sec. 16(2)]. (*See* implied condition 'as to merchantability' discussed earlier).

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5. Where the goods are bought by sample, the doctrine of *caveat emptor* does not apply if the bulk does not correspond with the sample, or if the buyer is not provided an opportunity to compare the bulk with the sample, or if there is any hidden or latent defect in the goods (Sec. 17). (*See* implied condition 'in a sale by sample' discussed earlier).
6. Where the goods are bought by sample as well as by description and the bulk of the goods does not correspond both with the sample and with the description, the buyer is entitled to reject the goods (Sec. 15). (*See* implied condition 'in a sale by sample as well as by description' discussed earlier).
7. Where the buyer makes known to the seller the purpose for which he requires the goods and relies upon the seller's skill and judgement but the goods supplied are unfit for the specified purpose, the principle of *caveat emptor* does not protect the seller and he is liable in damages [Sec. 16(1)]. (*See* 'condition as to fitness or quality' discussed earlier).
8. Where the trade usage attaches an implied condition or warranty as to quality or fitness and the seller deviates from that, the doctrine of *caveat emptor* does not apply and the seller is liable in damages [Sec. 16(3)].

Check Your Progress

4. Define 'warranty'.
5. State the points on the basis of which 'condition' and 'warranty' can be differentiated.

4.4 TRANSFER OF PROPERTY: IMPORTANCE AND RULES

While defining a contract of sale, we have seen that a sale is primarily the transfer of property in goods by the seller to the buyer. The phrase 'transfer of property in goods' means transfer of ownership of the goods. 'Property in goods' is different from possession of goods. Possession refers to the custody over the goods. So the property in goods may pass from the seller to the buyer but the goods may be in possession of the seller either as unpaid seller or as a bailee for the buyer. In other cases the property in goods may still be with the seller although the goods may be in possession of the buyer or his agent or a carrier for transmission to the buyer.

The precise moment of time at which property in goods passes from the seller to the buyer is of great importance from various points of view. Of these the following require special notice:

1. **Risk 'prima-facie' passes with property:** As a general rule the risk of the loss of goods is *prima-facie* in the person in whom property is. Section 26 provides to the same effect, thus, 'Unless otherwise agreed, the goods

remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to buyer, the goods are at the buyer's risk whether delivery has been made or not.' Thus, if after the contract the goods are destroyed or damaged the question who is to bear the loss is to be decided not on the basis of possession of the goods but on the basis of ownership of goods. Whosoever is the owner of the goods at the time of loss must bear the loss.

The opening words of Section 26, namely, 'unless otherwise agreed' are of great significance. These words imply that 'risk passes with property' is not an absolute or inflexible rule, but a *prima-facie* one. Risk is *no test of property passing*. There is nothing to prevent the parties from contracting that risk shall pass even before passing of property or *vice versa*.

The proviso to Section 26 also lays down an exception to the rule that 'risk follows ownership.' It provides that where delivery of the goods has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault as regards any loss which might not have occurred but for such fault.

2. **Action against third parties**: If after the contract of sale, the goods have been damaged by a third party, it is only the person in whom the property vests who can take action against the wrongdoer.
3. **Suit for price**: Generally speaking the seller can only sue for the price if the property in goods has passed to the buyer.
4. **Insolvency of the seller or the buyer**: In the event of insolvency of either the seller or the buyer, the answer to the question whether the Official Receiver or Assignee can take over the goods or not, shall depend upon whether the property in goods was with the party who has become insolvent. For example, if the seller becomes insolvent before giving delivery of the goods but the property in goods has already passed to the buyer who has paid the price, the Official Receiver can have no claim against the goods.

4.4.1 Rules of Transfer of Property

We shall be studying the rules regarding transfer of property under the following two heads:

A. Transfer of property in specific or ascertained goods.

B. Transfer of property in unascertained and future goods.

A. Transfer of Property in Specific or Ascertained Goods

Where there is a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred. For the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case [Sec. 19(1) (2)]. Thus, in the case of specific goods, the

transfer of property takes place when the parties intend to pass it. The parties may intend to pass the property at once at the time of making of the contract or when the goods are delivered or when the goods are paid for.

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It is only when the intention of the parties cannot be judged from their contract or conduct or other circumstances that the rules laid down in Sections 20, 21, 22 and 24 apply [Sec. 19(3)]. These rules are as follows:

1. **When goods are in a deliverable state** (Sec. 20): Where there is an unconditional (*i.e.*, not subject to any condition precedent to be fulfilled by the parties) contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer as soon as the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of the goods, or both are postponed.

   The goods are said to be in a 'deliverable state' when they are in such a state that the buyer would, under the contract, be bound to take delivery of them [Sec. 2(3)]. For example, in illustration (*b*) above, if the seller has to polish the table to make it acceptable to the buyer, it is not in a deliverable state until it is so polished, and the buyer does not acquire property at the time of the contract.

2. **When goods have to be put into a deliverable state** (Sec. 21): Where there is a contract for the sale of specific goods and the seller is bound to do 'something' to the goods for the purpose of putting them into a deliverable state, the property does not pass until such thing is done and the buyer has notice thereof. The word 'something' here means an act like packing the goods, or loading them on rail or ship, or filling them in containers or polishing them in order to give a finished shape, etc. It is to be noted that merely putting the things in a deliverable state would not result in the transfer of property in the goods from the seller to the buyer. It is further necessary that the buyer must have notice thereof, *i.e.*, the fact that the goods have been put in a deliverable state must come to the knowledge of the buyer in some way or the other.

3. **When the goods have to be measured etc., to ascertain price** (Sec. 22): Where there is a contract for the sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do some other act or thing with reference to the goods for the purpose of ascertaining the price, the property does not pass until such act or thing is done and the buyer has notice thereof.

   It may be noted that if the seller has done all what he was required to do under the contract and nothing remains to be done by him, the property passes to the buyer even if the buyer has to do something for his own satisfaction.

4. **When goods are delivered on approval** (Sec. 24): When goods are delivered to the buyer on approval or 'on sale or return,' or on other similar terms, the property therein passes to the buyer:

   (*i*) When he signifies his approval or acceptance to the seller or does any other act adopting the transaction, *e.g.*, uses the goods, pledges the goods or resells them;

   (*ii*) If he does not signify his approval or acceptance to the seller but retains the goods, without giving notice of rejection, beyond the time fixed for the return of goods, or if no time has been fixed, beyond a reasonable time.

B. Transfer of Property in Unascertained and Future Goods

The rule relating to transfer of property in unascertained and future goods is contained in Sections 18 and 23. These Sections provide that where goods contracted to be sold are not ascertained or where they are future goods, the property in goods does not pass to the buyer unless and until the goods are ascertained or unconditionally appropriated to the contract so as to bring them in a deliverable state, either by the seller with the assent of the buyer or by the buyer with the assent of the seller. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

It must be noted that the above rule (as contained in Secs. 18 and 23) is a fundamental rule and it applies irrespective of what the parties intended. Until goods are ascertained or appropriated there is merely 'an agreement to sell.' Thus a sale of ten quintals of wheat from a granary containing a large quantity, has not the effect of transferring property in the ten quintals to the purchaser. It amounts only to 'an agreement to sell.' It is only when ten quintals are appropriated to the contract by the seller and the buyer has notice thereof, that property shall pass from the seller to the buyer.

The process of ascertainment or appropriation consists in earmarking or setting apart goods as subject-matter of the contract. It involves separating, weighing, measuring, counting or similar acts done in relation to goods with an intention to identify and determine the specific goods to be delivered under the contract. The distinction between 'ascertainment' and 'appropriation' is that whereas 'ascertainment' can be a unilateral act of the seller, that is, he alone may set apart the goods, 'appropriation' involves the element of mutual consent of the seller and the buyer.

The following points should be noted as regards a valid or proper appropriation of the goods:

(*i*) The appropriation must be of goods answering the contract description, both as to quality and quantity.

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(*ii*) The appropriation must be intentional, *i.e.*, it must be made with intention to appropriate goods to specific contract, and it must not be due to mere accident or mistake.

(*iii*) The appropriation must be made either by the seller with the assent of the buyer or by the buyer with the assent of the seller. Assent of the other party is thus necessary; whether before or after the appropriation is made; for a valid appropriation.

(*iv*) The appropriation must be unconditional, *i.e*., the seller should not reserve to himself *the right of disposal of the goods* until and unless certain conditions are fulfilled.

Delivery to carrier [Sec. 23(2)]: A seller is deemed to have unconditionally appropriated the goods to the contract where he delivers the goods to a carrier or other bailee (whether named by the buyer or not) for the purpose of transmission to the buyer, and *does not reserve the right of disposal*. Thus delivery to a carrier without reserving the right of disposal is a delivery to the buyer and the property passes at once at the time of delivery to the carrier. *For example*, if goods have been loaded on rail and railway receipt is taken in the name of the buyer and the same is sent to him direct, the ownership is passed immediately on delivery to the railway company. But if the railway receipt, instead of sending direct to the buyer, is sent to the bank with instruction to deliver it to the buyer on payment of the price, the right of disposal is said to have been reserved and no property passes to the buyer on delivery to the railway company.

Reservation of right of disposal (Sec. 25): Reservation of the right of disposal means reserving a right to dispose of the goods until certain conditions (like payment of the price) are fulfilled. When the seller reserves such a right the property in the goods does not pass until those conditions are fulfilled. The seller may reserve such a right expressly while making a contract or while making appropriation of unascertained goods. He may also reserve this right by implication, for example, when the seller while transporting goods takes the railway receipt or the bill of lading in his own name or where the seller has taken the R/R or B/L in the name of the buyer but has delivered the same to his bank with the instructions that the document is to be delivered to the buyer only when he makes payment of the price or accepts the bill of exchange, the right of disposal is said to be reserved impliedly.

4.4.2 Rule of Transfer of Title on Sale

The general rule relating to the transfer of title on sale is that ‘the seller cannot transfer to the buyer of goods a better title than he himself has.’ If the title of the seller is defective the buyer’s title will also be subject to the same defect. Section 27 also lays down to the same effect and provides that ‘where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had....’ This rule is expressed by the maxim, ‘*nemo det quod non habet*,’’ which means that *no one can give what he has not got.*

The general rule aims at protecting the interests of the true owner and is deemed necessary in the larger interest of society. So if a thief disposes of stolen property, the buyer acquires no title though he may have purchased the goods *bona fide* for value, and the real owner of the goods is entitled to recover possession of goods without paying anything to the buyer. Similarly, where a hirer of goods under a hire purchase agreement sells them before he had paid all the instalments, the buyer, though acting in good faith, does not acquire the property in the goods against the true owner and, on default of payment by the hirer, the true owner can recover the goods from the buyer (*Whiteley & Co.* vs *Hilt*).

Thus a buyer cannot get a good title to the goods unless he purchases the goods from a person who is the owner thereof or who sells them under the authority or with the consent of the owner.

4.4.3 Transfer of Title By Non-Owners

The above general rule as to title is subject to the following exceptions where the buyer gets a better title to the goods than what the seller himself possesses:

1. **An unauthorised sale by a mercantile agent** (Sec. 27): A mercantile agent means an agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods [Sec. 2(9)]. Thus as a rule a mercantile agent *having an authority* to sell goods conveys a good title to the buyer. But by virtue of this provision (proviso to Sec. 27) a mercantile agent can convey a good title to the buyer even though he sells goods *without having any authority* from the principal to do so, provided the following conditions are satisfied:
   (*a*) He should be in possession of the goods or documents of title to the goods in his capacity as mercantile agent and with the consent of the owner,
   (*b*) He should sell the goods while acting in the ordinary course of business,
   (*c*) The buyer should act in good faith without having any notice, at the time of the contract, that the agent has no authority to sell.
2. **Transfer of title by estoppel** (Sec. 27): In the words of Lord Halsbury: 'Estoppel arises when you are precluded from denying the truth of anything, which you have represented as a fact, although it is not a fact.' Thus, estoppel means that a person who by his conduct or words leads another to believe that certain state of affairs existed, would be estopped from denying later on that such a state of affairs did not exist. The basis of estoppel is that it would be unfair or unjust to allow a party to depart from a particular state of affairs which he has permitted another person to believe to be true (*Central Newbury Car Auctions Ltd.* vs *Unity Finance Ltd*). Sometimes the doctrine of estoppel may estop or preclude the true owner from denying seller's right to sell the goods and thus an innocent buyer may have a good

title despite the want of authority of the seller. When the true owner of the goods by his conduct or words or by any act or omission leads the buyer to believe that the seller is the owner of the goods or has the authority to sell them, he cannot afterwards deny the seller's authority to sell. The buyer in such a case gets a better title than that of the seller. In reference to sale of goods, estoppel may arise in any of the following ways:

(*i*) The owner standing by, when the sale is effected, or

(*ii*) Still more, by his assisting the sale, or

(*iii*) By permitting goods to go into the possession of another with all the insignia of possession thereof and apparent title, or

(*iv*) If he has otherwise acted or made representations so as to induce the buyer to alter his position to his prejudice.

3. **Sale by a joint owner** (Sec. 28): If one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in the goods is transferred to any person who buys them from such joint owner in good faith without notice of the fact that the seller has no authority to sell. It may be noted that in the absence of this provision (*i.e.*, Sec. 28), the buyer would have obtained only the title of the co-owner and would have become merely a co-owner with the other co-owners. Hence the provision constitutes an exception to the rule — 'no one can give what he has not got.'

4. **Sale by person in possession under voidable contract** (Sec. 29): When a person has obtained possession of the goods under a voidable contract and he sells those goods before the contract has been rescinded, the buyer of such goods acquires a good title to them provided the buyer acts in good faith and without notice of the seller's defect of title. The Indian Contract Act also provides to the same effect when it lays down that the right to avoid a voidable contract exists only so long as the interests of a third person have not intervened. If before it is exercised the interests of a third person have intervened, *i.e.*, the buyer has sold the goods to a sub-buyer, the latter, if acting *bona fide* gets a good title and the original vendor cannot claim the goods back from the sub-buyer.

   It is to be noted that this Section (Sec. 29) does not apply unless there is a contract. Thus it does not apply to a contract originally void or where goods have been obtained by theft.

5. **Sale by seller in possession after sale** [Sec. 30(1)]: Where a seller, after having sold the goods, continues to be in possession of the goods or of the documents of title to them and again sells or pledges them either himself or through a mercantile agent, he will convey a good title to the buyer or the pledgee provided the buyer or the pledgee acts in good faith and without notice of the previous sale. For the application of this exception it is essential that the possession of the seller must be as seller and not as hirer or bailee.

NOTES

6. **Sale by buyer in possession after 'agreement to buy'** [Sec. 30(2)]: Where a buyer has agreed to buy the goods and has obtained possession of the same or the documents of title to them with the consent of the seller, resells or pledges the goods either himself or through a mercantile agent, he will convey a good title to the buyer or the pledgee provided the person receiving the goods acts in good faith and without notice of any lien or other right of the original seller in respect of those goods.

   It is to be noted that a person who has got merely 'an option to buy,' as in a hire-purchase agreement, cannot convey a good title to a sub-buyer, however *bona fide*, for 'an option to buy' is not 'an agreement to buy' (*Belsize Motor Supply Co.* vs *Cox*). In order to make this exception applicable it is essential that the person must have obtained possession of the goods under 'an agreement to sell' (*i.e.*, under 'an agreement to buy' from the buyer's point of view).
7. **Resale by an unpaid seller** [Sec. 54(3)]: Where an unpaid seller, who has exercised his right of lien or stoppage in transit, resells the goods (of which ownership has passed to the buyer), the subsequent buyer acquires a good title thereto as against the original buyer, even though the resale may not be justified in the circumstances, *i.e.*, no notice of the resale has been given to the original buyer.
8. **Exceptions under other Acts:** Other Acts also contain some provisions under which a non-owner may pass to the buyer a better title than he himself has. For example:
   (*a*) Sale by finder of lost goods under certain circumstances (Sec. 169, *The Indian Contract Act*).
   (*b*) Sale by pawnee or pledgee under certain circumstances (Sec. 176, *The Indian Contract Act*).
   (*c*) Sale by Official Receiver or Assignee in case of insolvency of an individual and Liquidators of companies. These persons are not owners of the properties they deal in, but convey a better (good) title to the buyers than they themselves possess.
   (*d*) Under the Negotiable Instruments Act, a holder in due course gets a better title than what his endorser had. In other words, a person who takes a negotiable instrument in good faith and for value becomes the true owner even if he takes it from a thief or finder.

Check Your Progress

6. What do you understand by transfer of property in goods?
7. What is the distinction between 'ascertainment' and 'appropriation'?

4.5 PERFORMANCE OF CONTRACT SALES

'It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them, in accordance with the terms of the contract of sale' (Sec. 31). Thus, the performance of a contract of sale implies *delivery of goods* by the seller and *acceptance of the delivery* of goods and *payment* for them by the buyer, in accordance with the contract. The parties are free to provide any terms they like in their contract about the time, place and manner of delivery of goods, acceptance thereof and payment of the price. But if the parties are silent and do not provide any thing regarding these matters in the contract then the rules contained in the Sale of Goods Act are applicable.

4.5.1 Delivery

Delivery of goods means *voluntary transfer of possession* of goods from one person to another [Sec. 2(2)]. If transfer of possession of goods is not voluntary, *i.e.*, possession is obtained under pistol point or by theft, there is no delivery.

Modes of Delivery

Delivery of goods may be made in any of the following ways:

1. **Actual delivery**: Where the goods are physically handed over by the seller (or his authorised agent) to the buyer (or his authorised agent), the delivery is said to be actual. For example, the seller of a car hands over the car to the buyer, there is actual delivery of the goods.
2. **Symbolic delivery**: Here the goods remain where they are (probably because they are bulky), but the means of obtaining possession of goods is delivered. For example, the seller hands over to the buyer the key of the godown where the goods are stored, or transfers a document of title (*i.e.*, bill of lading or railway receipt) to the buyer which will entitle him to obtain the goods.
3. **Constructive delivery or delivery by attornment**. Such a delivery takes place when the person in possession of the goods of the seller acknowledges, in accordance with the seller's order that he holds the goods on behalf of the buyer and the buyer has assented to it. Note that in such a delivery all the three parties, namely, the seller, the person holding the seller's goods and the buyer, must concur. For example, where the seller hands over the 'delivery order' to the buyer and the warehouseman, who was holding the goods as a bailee of the seller, agrees and acknowledges to hold them on behalf of the buyer, there is a constructive delivery. Similarly, where the seller after selling the goods agrees to hold them on behalf of the buyer as his bailee there is deemed to be delivery of the goods to the buyer.

4.5.2 Rules of Delivery of Goods

The rules regarding delivery of goods are as follows:

1. **Delivery may be either actual or symbolic or constructive** (Sec. 33): Delivery of goods sold may be made by doing anything which the parties agree shall be treated as delivery or which has the effect of putting the goods in the possession of the buyer or of any person authorised to hold them on his behalf. Thus, the delivery of the goods may be either *actual*, or *symbolic* or *constructive*. (These terms have already been explained under the preceding heading.)
2. **Delivery and payment are concurrent conditions** (Sec. 32): Unless otherwise agreed, delivery of the goods and payment of the price are *concurrent conditions*, that is, the seller should be ready and willing to deliver the goods to the buyer in exchange for the price and the buyer should be ready and willing to pay the price in exchange for possession of the goods simultaneously, just like in a cash sale over a shop counter.
3. **Effect of part delivery, when property in goods is to pass on delivery** (Sec. 34): A delivery of part of the goods, in progress of the delivery of the whole, has the same effect, for the purpose of passing the property in such goods, as a delivery of the whole. In other words, when a delivery of part of the goods has been made with the intention of delivering the rest also, the property in the whole of the goods is deemed to pass to the buyer as soon as some portion is delivered.

   But when a part of the goods is delivered with the intention of severing it from the whole, it is not regarded as delivery of the whole of the goods and the property is deemed to pass to the buyer in that portion of the goods only which has been delivered.

   It may be emphasised that the above stated rules are applicable only when passing of property has been made dependent on delivery of the goods. In fact these rules are declaratory of the general law relating to transfer of property (which has already been discussed in the preceding unit).
4. **Buyer to apply for delivery** (Sec. 35): Although it is the duty of the seller to deliver the goods according to the contract, yet he is not bound to deliver them until the buyer applies for delivery. It is the duty of the buyer to demand delivery, and if he fails to do so, he cannot blame the seller for the non-delivery. The parties may, however, agree otherwise.
5. **Time of delivery** [Sec. 36(2) & (4)]: Where under the contract of sale the seller is bound to send the goods to the buyer, but no time for sending them is fixed, the seller is bound to send them within a reasonable time. Further, demand of delivery by the buyer or the tender of delivery by the seller should be made at a reasonable hour. What is a reasonable hour is a question of fact.

6. **Place of delivery** [Sec. 36(1)]: The place of delivery may be stated in the contract of sale, and where it is so stated, the goods must be delivered at the named place during business hours on a working day. But where no place is mentioned in the contract, the following rules must be followed:
   (*i*) In the case of 'sale,' the goods are to be delivered at the place at which they are at the time of the sale.
   (*ii*) In 'an agreement to sell,' the goods are to be delivered at the place where they are at the time of the agreement to sell.
   (*iii*) In the case of future goods, the goods are to be delivered at the place at which they are manufactured or produced.

   Where the seller of goods agrees to deliver them at his own risk at a place other than that where they are when sold, the buyer must, nevertheless, unless otherwise agreed, take any risk of deterioration in the goods necessarily incidental to the course of transit (Sec. 40).

7. **Delivery of goods where they are in possession of a third party** [Sec. 36(3)]: Where the goods at the time of sale are in the possession of a third person, there is no delivery by the seller to the buyer unless and until such third person acknowledges to the buyer that he holds the goods on his behalf. Such a delivery is known as 'constructive delivery' or 'delivery by attornment' and requires the consent of all the three parties, the seller, the buyer and the person having possession of the goods. Where the seller hands over the 'delivery order' to the buyer, there is no delivery unless the seller's agent holding the goods has assented thereto.

   But where the goods have been sold by the transfer of the document of title to goods, *e.g.*, railway receipt or bill of lading, the buyer is deemed to be in possession of the goods represented by such document, and the assent of the third party is not required.

8. **Expenses of delivery** [Sec. 36(5)]: Unless otherwise agreed, the expenses of and incidental to putting the goods into a deliverable state must be borne by the seller.

9. **Delivery of wrong quantity or different quality** (Sec. 37): As already observed, a seller is duty bound to deliver the goods to the buyer strictly in accordance with the terms of the contract. A defective delivery, *i.e.*, delivery of a *quantity less or more* than that contracted for *or* delivery of goods *mixed with the goods of a different description* not included in the contract, entitles the buyer:
   (*i*) to reject the whole, or
   (*ii*) to accept the whole, or
   (*iii*) to accept the quantity and quality he ordered and reject the rest of the goods so delivered.

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Remember that in case of rejection of goods because of defective delivery the buyer is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them (Sec. 43). Further, the right to reject the goods is not equivalent to right to cancel the contract. If the buyer rejects the goods, the seller has a right to tender again goods of contract quality and quantity subject to the terms and conditions of the contract and the buyer is bound to accept the same (*Vilas Udyog Ltd.* vs *Prag Vanaspati*).

Where the buyer accepts the goods, he must pay for what he has actually accepted, at the contract rate. In case the buyer has accepted short delivery he is entitled to claim damages for the same from the seller. If, however, the deficiency or excess is so small as to be negligible, the court does not take account of that, and the buyer must accept the goods. This is based on the *maxim* that 'the law does not take trivial deviations into account.'

The above provisions are subject to any usage of trade, special agreement or course of dealing between the parties [Sec. 37(4)].

10. **Instalment deliveries** (Sec. 38): Unless otherwise agreed, the buyer of goods is not bound to accept delivery thereof by instalments. If the parties so agree then only the delivery of the goods may be made by instalments.

    When the parties agree that the delivery is to be made by instalments and each instalment is to be separately paid for, and either buyer or seller commits a breach of contract in respect of one or more instalments, there arises a question as to whether such a breach amounts to a breach of the whole of the contract or a breach of only a part of it? The answer to this question depends upon the terms of the contract and the circumstances of the case. Unless otherwise agreed the following two factors must be borne in mind in deciding the whole matter:

    (*a*) The quantitative proportion which the breach bears to the contract as a whole, and

    (*b*) The degree of probability of the repetition of the breach (*Maple Flock Co. Ltd.* vs *Universal Furniture Products Ltd.*).

    Generally, failure to deliver or pay for one instalment does not amount to a breach of the whole contract, unless from the special circumstances of the case (*e.g.*, the factory is closed because of a labour strike or the buyer becomes insolvent) it can be inferred that similar breaches will be repeated.

11. **Delivery to carrier or wharfinger** (Sec. 39): Where the seller is authorised or required to send the goods to the buyer, delivery of the goods to a carrier, whether named by the buyer or not, for the purpose of transmission to the buyer, or delivery of the goods to a wharfinger for safe custody, is *prima facie* deemed to be a delivery of the goods to the buyer.

Seller's duty: Unless the buyer requires to despatch the goods at owner's risk, it is the duty of the seller, when he delivers the goods to the carrier or wharfinger, to enter into a reasonable contract on behalf of the buyer for the safety of the goods, and if he fails to do so, and the goods are lost or damaged, the buyer may decline to treat the delivery to the carrier or wharfinger as a delivery to himself, or may hold the seller responsible in damages.

Sea transit. Unless otherwise agreed, where goods are sent by the seller to the buyer by a route involving sea transit, where it is usual to insure, the seller must inform the buyer in time to get the goods insured during their sea transit, and if the seller fails to do so, the goods shall be deemed to be at his risk during such sea transit.

12. **Liability of buyer for neglecting or refusing to take delivery of goods** (Sec. 44): When the seller is ready and willing to deliver the goods and requests the buyer to take delivery, and the buyer does not within a reasonable time after such request take delivery of the goods, he becomes liable to the seller for any loss occasioned by his neglect or refusal to take delivery, and also for a reasonable charge for the care and custody of the goods.

4.5.3 Acceptance of Delivery by Buyer

The mere fact that the buyer has taken the delivery of the goods does not amount to acceptance of them. According to Section 42, the buyer is deemed to have accepted the goods in either of the following circumstances, namely:

1. When he intimates to the seller that he has accepted the goods.

   Before intimating about acceptance the buyer has a right, under Section 41, to examine and test the goods in order to be sure as to whether they are in conformity with the contract regarding quality etc. He may even use the goods, if it is necessary for the purpose of testing, *e.g.*, in the case of a horse sale conditioned to run at 25 kilometers per hour it is necessary to use the horse for ascertaining, whether the horse is in conformity with the contract. But if he is not satisfied, he must act promptly to inform the seller about rejection.
2. When he does any act in relation to the goods which is inconsistent with the ownership of the seller, *e.g.*, consumes, uses, pledges or resells the goods or puts his mark on them.
3. When, after the lapse of a reasonable time, he retains the goods without intimating the seller that he has rejected them. What is reasonable time is a question of fact. If time for rejection is stipulated, rejection must be within that period. It may be mentioned that on rejection of goods because of defective delivery, mere informing the seller is enough and the buyer is not bound to return the rejected goods to the seller (Sec. 43).

Check Your Progress

8. What do you understand by the term 'delivery of goods'?
9. What is 'symbolic delivery'?

NOTES

4.6 UNPAID SELLER AND HIS/HER RIGHTS

The seller of goods is deemed to be an 'unpaid seller' (*a*) when the *whole* of the price has not been paid or tendered; or (*b*) where a bill of exchange or other negotiable instrument has been received as a conditional payment, *i.e.,* subject to the realisation thereof, and the same has been dishonoured.

The term 'seller' here includes any person who is in the position of a seller, as, for instance, an agent of the seller to whom the bill of lading had been endorsed, or a consignor or agent who has himself paid, or is directly responsible for, the price. (Sec. 45)

This definition emphasises the following characteristics of an 'unpaid seller':

1. He must sell goods on cash terms and not on credit, and he must be unpaid.
2. He must be unpaid either wholly or partly. Even if only a portion of the price, however small, remains unpaid, he is deemed to be an unpaid seller. Where the price is paid through a bill of exchange or other negotiable instrument, the same must be dishonoured.
3. He must not refuse to accept payment when tendered. If the price has been tendered by the buyer but the seller wrongfully refuses to take the same, he ceases to be an unpaid seller.

4.6.1 Rights of an Unpaid Seller

An unpaid seller has two-fold rights. These are as follows:

1. Rights of unpaid seller against the goods, and
2. Rights of unpaid seller against the buyer personally.

We shall now examine these rights in detail.

1. Rights of Unpaid Seller against the Goods

An unpaid seller has the following rights against the goods notwithstanding the fact that the property in the goods has passed to the buyer:

i. Right of lien;
ii. Right of stoppage of goods in transit;
iii. Right of resale [Sec. 46(I)].

i. Right of Lien (Sec. 47)

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'Lien' is the right to retain possession of goods and refuse to deliver them to the buyer until the price due in respect of them is paid or tendered. An unpaid seller in possession of goods sold is entitled to exercise his lien on the goods in the following cases:

(*a*) Where the goods have been sold without any stipulation as to credit;

(*b*) Where the goods have been sold on credit but the term of credit has expired;

(*c*) Where the buyer becomes insolvent, even though the period of credit may not have yet expired.

In the case of buyer's insolvency the lien exists even though goods had been sold on credit and the period of credit has not yet expired. When the goods are sold on credit the presumption is that the buyer shall keep his credit good. If, therefore, before payment the buyer becomes insolvent, the seller is entitled to exercise this right and hold the goods as security for the price. The effect of buyer's insolvency is that all stipulations as to credit are put to an end and the seller has a right to say, 'I will not deliver the goods until I see that I shall get my price paid' (*Griffiths* vs *Perry*).

The unpaid seller's lien is a possessory lien, *i.e.,* the lien can be exercised as long as the seller remains in possession of the goods. He may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer [Sec. 47(2)]. Transfer of property in the goods or transfer of documents of title to the goods does not affect the exercise of this right, provided the goods remain in the actual possession of the seller. In fact when property has passed to the buyer then only retaining of goods is called technically 'lien.' Where the property in goods has not passed to the buyer and the title is still with the seller then it is, strictly speaking, anomalous to say that the seller has a lien against his own goods. The seller's lien when property has not passed to the buyer is termed as '*a right of withholding delivery.*' Accordingly, Section 46(2) provides:

'Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and coextensive with his rights of lien and stoppage in transit where the property has passed to the buyer.'

This right of lien can be exercised only for the non-payment of the price and not for any other charges, *e.g.,* maintenance or custody charges, which the seller may have to incur for storing the goods in exercise of his lien for the price. This right of lien extends to the whole of the goods in his possession even though part payment for those goods has already been made. In other words the buyer is not entitled to claim delivery of a portion of the goods on payment of a proportionate price. Further, where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an agreement to waive the lien (Sec. 48).

Also, the lien can be exercised even though the seller has obtained a 'decree' for the price of the goods [Sec. 49(2)].

As already observed, lien depends on physical possession of goods. Once the possession is lost, the lien is also lost. Section 49 accordingly provides that the unpaid seller of goods loses his lien thereon in the following cases:

(*a*) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the right of disposal of the goods; or

(*b*) When the buyer or his agent lawfully obtains possession of the goods; or

(*c*) When the seller expressly or impliedly waives his right of lien. An implied waiver takes place when the seller grants fresh term of credit or allows the buyer to accept a bill of exchange payable at a future date or assents to a sub-sale which the buyer may have made.

It may be noted that right of lien, if once lost, will not revive if the buyer redelivers the goods to the seller for any particular purpose. Thus, where a refrigerator after being sold was delivered to the buyer and since it was not functioning properly, the buyer delivered back the same to the seller for repairs, it was held that the seller could not exercise his lien over the refrigerator (*Eduljee* vs *John Bros.*).

ii. Right of Stoppage of Goods in Transit

The right of stoppage in transit means the right of *stopping further transit* of the goods while they are with a carrier for the purpose of transmission to the buyer, resuming possession of them and retaining possession until payment or tender of the price. Thus, in a sense this right is an extension of the right of lien because it entitles the seller to regain possession even when the seller has parted with the possession of the goods.

An unpaid seller can exercise this right (Sec. 50) only when:

(*a*) *The buyer becomes insolvent:* The buyer is said to be insolvent when he has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he is declared an insolvent or not [Sec. 2(8)]; and

(*b*) *The property has passed to the buyer:* If property has not passed to the buyer then this right is termed as the 'right of withholding delivery' [Sec. 46(2)]; and

(*c*) *The goods are in the course of transit:* This means that goods must be neither with the seller nor with the buyer nor with their agent. They should be in the custody of a carrier as an *independent middleman (i.e.,* in his own right as a carrier) *e.g.,* railways and common carriers whose business is to transport goods of others. The carrier must not be either seller's agent or buyer's agent. Because if he is seller's agent,

the goods are still in the hands of seller in the eye of law and hence there is no transit, and if he is buyer's agent, the buyer gets delivery in the eye of law and hence question of stoppage does not arise.

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Some other aspects of transit and stoppage are:

(a) Duration of transit (Sec. 51): Since the right of stoppage in transit can be exercised only so long as the goods are in the course of transit, it becomes necessary to know as to when the transit begins and when it comes to an end. When the transit comes to an end the right of stoppage cannot be exercised.

According to Section 51, goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent takes delivery of them. Thus the transit continues so long as the goods are not delivered to the buyer or his agent, no matter whether they are lying at the destination with the carrier awaiting transmission or are in actual transit. The goods are still deemed to be in transit if they are rejected by the buyer and the carrier or other bailee continues in possession of them, even if the seller has refused to receive them back.

The transit is deemed to be at an end and the seller cannot exercise his right of stoppage in the following cases:

(*a*) When the buyer or his agent takes delivery after the goods have reached destination.

(*b*) When the buyer or his agent obtains delivery of the goods before their arrival at the appointed destination.

(*c*) When the goods have arrived at their destination and the carrier acknowledges to the buyer or his agent that he holds the goods on his behalf.

(*d*) When the goods have arrived at their destination but the buyer instead of taking delivery requests the carrier to carry the goods to some further destination and the carrier agrees to take them to the new destination.

(*e*) When the carrier wrongfully refuses to deliver the goods to the buyer or his agent.

(*f*) When part delivery of the goods has been made to the buyer with an intention of delivering the whole of the goods, transit will be at an end for the remainder of the goods also which are yet in the course of the transit.

(b) How right of stoppage is exercised (Sec. 52): The unpaid seller may exercise his right of stoppage in transit either:

(*a*) By taking actual possession of the goods, or

(*b*) By giving notice of his claim to the carrier or other bailee in whose possession the goods are.

Such notice may be given either (*a*) to the person in actual possession of the goods, or *(b)* to his principal. In the latter case, notice must be given well in advance to enable the principal to communicate with his agent or servant in time, so as to prevent delivery to the buyer.

It is the duty of the carrier, after receiving due notice, not to deliver the goods to the buyer but to redeliver them to, or according to the directions of the seller. If by mistake he delivers the goods to the buyer, he can be made liable for conversion. The expenses of redelivery are to be borne by the seller.

c. Distinction between Lien and Stoppage in Transit

The main points of distinction between these two rights of an unpaid seller are as follows:

1. The seller's lien attaches when the buyer is in default, whether he be solvent or insolvent. The right of stoppage in transit arises only when the buyer is insolvent.
2. Lien is available only when the goods are in actual possession of the seller while right of stoppage is available when the seller has parted with possession and the goods are in the custody of an independent carrier.
3. The right of lien comes to an end once the seller hands over the possession of the goods to the carrier for the purpose of transmission to the buyer. On the other hand, the right of stoppage in transit commences after the seller has delivered the goods to a carrier for the purposes of transmission to the buyer and continues until the buyer has acquired their possession.
4. The right of lien consists in retaining the possession of the goods while the right of stoppage consists in regaining possession of the goods.

d. Effect of Sub-sale or Pledge by Buyer upon the 'Two Rights of the Unpaid Seller' discussed above (Sec. 53)

The unpaid seller's right of lien or stoppage in transit is not affected by any sale or other disposition (*e.g.,* pledge) of the goods which the buyer might have made. For example, *P* sells certain goods to *R* and delivers them to a carrier for transmission to *R*. Before the goods reach their destination *P* comes to know that *R* has become insolvent. In the meanwhile *R* sells those goods to *Q*. The sale of goods between *P* and *Q* will not affect the right of *P* to stop them in transit.

But there are two *exceptional cases* when these two rights of the unpaid seller are affected by a sale or other disposition (*e.g*., pledge) of the goods by the buyer. These exceptions are:

(*i*) When the seller has assented to the sale or other disposition (*e.g.,* pledge) which the buyer may have made.

(*ii*) When a document of title to goods (*e.g.,* a bill of lading or railway receipt) has been issued or transferred to a buyer, and the buyer transfers the document to a person who takes the document in good faith and for consideration, then,

(*a*) if such last mentioned transfer was by way of sale, the unpaid seller's right of lien or stoppage in transit is defeated, and

(*b*) if such last mentioned transfer was by way of pledge, the unpaid seller's right of lien or stoppage in transit can only be exercised subject to the rights of the pledgee. But in this case the unpaid seller may require the pledgee to satisfy his claim against the buyer first out of any other goods or securities of the buyer in the hands of the pledgee.

iii. Right of Resale

The right of resale is a very valuable right given to an unpaid seller. In the absence of this right, the unpaid seller's other rights against the goods, namely, 'lien' and 'stoppage in transit,' would not have been of much use because these rights only entitle the unpaid seller to retain the goods until paid by the buyer. If the buyer continues to remain in default, then should the seller be expected to retain the goods indefinitely, especially when the goods are perishable? Obviously, this cannot be the intention of the law. Section 54, therefore, gives to the unpaid seller *a limited right to resell* the goods in the following cases:

(*a*) Where the goods are of a perishable nature; or

(*b*) Where such a right is expressly reserved in the contract in case the buyer should make a default; or

(*c*) Where the seller has given a notice to the buyer of his intention to resell and the buyer does not pay or tender the price within a reasonable time.

If on a resale there is a loss to the seller, he can recover it from the defaulting buyer. But if there is a surplus on the resale, the seller can keep it with him because the buyer cannot be allowed to take advantage of his own wrong. If, however, no notice of resale [as required in case (*c*) above] is given to the buyer, the right of seller to claim loss and retain surplus, if any, is reversed. In other words, if the unpaid seller fails to give notice of resale to the buyer, where *neither* the goods are of perishable nature *nor* such a right was expressly reserved, he cannot recover the loss from the buyer and is under an obligation to hand over the surplus, if any, to the buyer, arising from the resale. Thus, it will be seen that *giving of notice to the buyer*, when so required, is very necessary to make him liable for the breach of contract. It is so because such a notice gives an opportunity to the buyer either to pay the price and have the goods, or, if he cannot pay, to supervise the sale to see that the same is properly made.

It is important that absence of notice, when so required, affects the rights of the unpaid seller himself only as discussed above and it does not affect the title of the subsequent buyer who will acquire a good title to the goods. Section 54(3) specially declares— 'Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods, the buyer acquires a good title thereto as against the original buyer, notwithstanding that no notice of the resale has been given to the original buyer.'

2. Rights of Unpaid Seller against the Buyer Personally

The unpaid seller, in addition to his rights against the goods as discussed above, has the following three rights of action against the buyer personally:

1. **Suit for price** (Sec. 55): Where property in goods has passed to the buyer; or where the sale price is payable 'on a day certain', although the property in goods has not passed; and the buyer wrongfully neglects or refuses to pay the price according to the terms of the contract, the seller is entitled to sue the buyer for price, irrespective of the delivery of goods. Where the goods have not been delivered, the seller would file a suit for price normally when the goods have been manufactured to some special order and thus are unsaleable otherwise.
2. **Suit for damages for non-acceptance** (Sec. 56): Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may sue him for damages for non-acceptance. The seller's remedy in this case is a suit for damages rather than an action for the full price of the goods.

   The damages are calculated in accordance with the rules contained in Section 73 of the Indian Contract Act, that is, the measure of damages is the estimated loss arising directly and naturally from the buyer's breach of contract. Where the goods have a ready market the principle applicable is that the seller may recover from the buyer damages equal to the difference between the contract price and the market price on the date of the breach of the contract. Thus, if the difference between the contract price and market price is nil, the seller can get only nominal damages (*Charter* vs *Sullivan*). But where the goods do not have any ready market, the measure of damages will depend upon the facts of each case. For example, in *Thompson Ltd*. vs *Robinson,* the damages were assessed on the basis of profits lost. In that case, *T Ltd*., who were car dealers, contracted to supply a motorcar to *R*. *R* refused to accept delivery. It was found as a fact that the supply of cars exceeded the demand at the time of breach and hence in a sense there was no market price on the date of breach. Hence, *T Ltd*., were entitled to damages for the loss of their bargain *viz*., the profit they would have made, as they had sold one car less than they otherwise would have sold. To take another illustration, if the goods have been manufactured to some special order and they are unsaleable and have no value at all for other buyers, then the seller may even be allowed the full price of the goods as damages.
3. **Suit for special damages and interest** (Sec. 61): This Section entitles the seller to sue the buyer for 'special damages' also for such loss 'which the parties knew, when they made the contract, to be likely to result from the breach of it.' In fact the Section is only declaratory of the principle regarding 'special damages' laid down in Section 73 of the Indian Contract Act. The Section also recognises unpaid seller's right to get interest at a

reasonable rate on the total unpaid price of the goods sold, from the time it was due until it is actually paid (*Telu Ram Jain* vs *Aggarwal & Sons*).

4.6.2 Buyer's Rights Against Seller

The buyer has the following rights against the seller for breach of contract:

1. **Suit for damages for non-delivery** (Sec. 57): Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue the seller for damages for non-delivery.

   The damages are assessed in accordance with the rules contained in Section 73 of the Indian Contract Act, that is, the measure of damages shall be the estimated loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract. If the goods in question have a ready market the measure of damages is *prima facie* to be ascertained by the difference between the contract price and market price on the date of breach. Section 61 entitles the buyer to sue the seller for 'special damages' also for such loss which the seller knew when they made the contract to be likely to result from the breach of it.

2. **Suit for specific performance** (Sec. 58): Where there is breach of a contract for the sale of specific or ascertained goods, the buyer may file a suit for the specific performance of the contract. This remedy is discretionary and will only be granted when damages would not be an adequate remedy, for instance, the subject-matter of the contract is rare goods, say, a picture by a dead painter.

3. **Suit for damages for breach of warranty** (Sec. 59): Where there is a breach of warranty by the seller, or where the buyer elects or is compelled to treat breach of condition as breach of warranty, the buyer is entitled to file a suit for damages if the price has already been paid. But if the buyer has not yet paid the price he may ask the seller for a reasonable reduction in price.

   Here also damages are to be ascertained in accordance with the provisions of Section 73 of the Indian Contract Act. Thus, the loss arising directly and naturally from the breach, *i.e.*, the difference between the value of the goods as delivered, and the value they would have had if the goods had answered to the warranty, can be recovered.

4. **Suit for rescission of contract and for damages for breach of 'condition':** The breach of 'condition' entitles the buyer to treat the contract as repudiated [Sec. 12(2)]. Accordingly, where there is a breach of 'condition' by the seller, the buyer is entitled to file a suit for rescission of the contract. Also, he may claim damages for loss suffered on the footing that the whole contract is broken and the seller is guilty of non-delivery (*Millar's Machinery Co. Ltd.* vs *David Way & Son*).

5. **Suit for recovery of the price together with interest** (Sec. 61): If the buyer has already paid the price of the goods to the seller and the goods are not delivered or they are stolen one, he can sue the seller for the refund of the price and also for the interest at reasonable rate from the date of payment to the date of refund.

4.6.3 Auction Sale

In an auction sale, the auctioneer invites bids from prospective purchasers and sells the goods to the highest bidder. Section 64 lays down the following rules relating to an auction sale:

1. Where goods are put up for sale in lots, each lot is *prima facie* deemed to be the subject of a separate contract of sale.
2. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner, say, by saying words like 'one, two, three' or 'going, going, gone;' and, until such announcement is made, any bidder may retract his bid. On the other hand, the auctioneer is also not bound to accept the highest bid if he feels that it is much below his expectation. Of course, his not accepting the highest bid would injure his business reputation because it is the custom of trade that goods must be sold to the highest bidder.

   In the language of the Contract Act, a notice or advertisement of an auction sale is simply 'an invitation to an offer.' The bid constitutes the 'offer,' and the fall of hammer constitutes the 'acceptance.' An offer can always be withdrawn before its acceptance, and need not necessarily be accepted. In this connection, it may be of interest to note that the auctioneer has the right to make the auction subject to any conditions he likes (*The Coffee Board* vs *Famous Coffee and Tea Works*). Thus, if the auctioneer expressly announces that biddings once made cannot be withdrawn, then that will hold good and the normal contractual rule, *i.e.*, an offer may be revoked before its acceptance will not apply.
3. The seller or any one person on his behalf can bid at the auction, provided such a right to bid has been expressly reserved at the time of notifying the auction sale. (The employment of a second puffer is fraudulent even if the right to bid is expressly reserved). If the seller makes use of pretended bidding to raise the price without expressly notifying about the same, the sale may be treated as fraudulent by the buyer and he may avoid the contract on that ground.
4. The sale may be notified to be subject to a *reserved or upset* price It is a price below which the auctioneer will not sell, and if he by mistake knocks down the lot for less than the reserved price, no valid contract comes into existence and he can refuse to deliver the goods to the highest bidder (*Rainbow* vs *Hawkins*). Where the sale is 'without reserve' the goods

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must be sold to the highest bidder, irrespective of the bid amount. But it is only a usage or custom of the trade because otherwise the auctioneer is free to accept or reject any offer or bid made to him.

5. A 'knock out' agreement between intending buyers not to bid against each other is not illegal (*Lachman Dass & Others* vs *Sita Ram & Others*).
6. The auctioneer cannot sell goods on credit or accept payment by means of a bill of exchange. Also, he cannot be compelled to accept a cheque for the purchase price.

Check Your Progress

10. Who is an 'unpaid seller'?
11. How is the right of stoppage exercised?

4.7 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Goods may be classified into three types–Existing goods, Future goods and Contingent goods.
2. The money consideration for a sale of goods is known as 'price'. It is an essential element of a contract of sale of goods and no valid sale can take place without a price.
3. Price may be either expressly fixed by the contract itself, or it may be fixed in accordance with an agreed manner provided by the contract, or may be determined by the course of dealings between the parties. If the price is not capable of being determined in accordance with any of the above modes, the buyer is bound to pay to the seller a 'reasonable price'.
4. A 'warranty' is a stipulation *collateral* to the main purpose of the contract, the breach of which gives the aggrieved party a right to sue for damages only, and not to avoid the contract itself.
5. The points of distinction between a condition and a warranty may be summed up as under:
   - As to value
   - As to breach
   - As to treatment
6. The phrase 'transfer of property in goods' means transfer of ownership of the goods.

   'Property in goods' is different from possession of goods. Possession refers to the custody over the goods. So the property in goods may pass from the

seller to the buyer but the goods may be in possession of the seller either as unpaid seller or as a bailee for the buyer. In other cases the property in goods may still be with the seller although the goods may be in possession of the buyer or his agent or a carrier for transmission to the buyer.

7. The distinction between 'ascertainment' and 'appropriation' is that whereas 'ascertainment' can be a unilateral act of the seller, that is, he alone may set apart the goods 'appropriation' involves the element of mutual consent of the seller and the buyer.
8. Delivery of goods means voluntary transfer of possession of goods from one person to another.
9. Symbolic delivery is when the goods remain where they are (owing to their weight, or size, etc.) but the means of obtaining possession of goods is delivered. For example, the seller hands over to the buyer the key of the godown where the goods are stored, or transfers a document of title (i.e., bill of lading or railway receipt) to the buyer entitling him to obtain the goods.
10. The seller of goods is deemed to be an 'unpaid seller' (a) when the whole of the price has not been paid or tendered; or (b) where a bill of exchange or other negotiable instrument has been received as a conditional payment, i.e., subject to the realization thereof, and the same has been dishonoured.
11. The unpaid seller may exercise his right of stoppage in transit either:
    (a) by taking actual possession of the goods, or
    (b) by giving notice of his claim to the carrier or other bailee in whose possession the goods are.

4.8 SUMMARY

- The general provisions of the Indian Contract Act continue to be applicable to the contract of sale of goods in so far as they are not inconsistent with the express provisions of Sale of Goods Act (Sec. 3).
- The goods which are not separately identified or ascertained at the time of the making of the contract are known as 'unascertained goods.' They are indicated or defined only by description.
- It is to be remembered that unless otherwise agreed, payment of the price and delivery of the goods are concurrent conditions (Sec. 32). Again, Section 64-A, which provides for 'Escalation Clause,' is important.
- A contract of sale of goods contains various terms or stipulations regarding the quality of the goods, the price and the mode of its payment, the delivery of goods and its time and place. But all of them are not of equal importance.
- Conditions and warranties may be either express or implied. They are said to be express when at the will of the parties they are inserted in the contract,

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and they are said to be implied when the law presumes their existence in the contract automatically though they have not been put into it in express words.

- According to the doctrine of caveat emptor, it is the duty of the buyer to be careful while purchasing goods of his requirement and, in the absence of any enquiry from the buyer, the seller is not bound to disclose every defect in goods of which he may be cognisant.
- Property in goods' is different from possession of goods. Possession refers to the custody over the goods. So the property in goods may pass from the seller to the buyer but the goods may be in possession of the seller either as unpaid seller or as a bailee for the buyer.
- The general rule relating to the transfer of title on sale is that 'the seller cannot transfer to the buyer of goods a better title than he himself has.' If the title of the seller is defective the buyer's title will also be subject to the same defect.
- Sometimes the doctrine of estoppel may estop or preclude the true owner from denying seller's right to sell the goods and thus an innocent buyer may have a good title despite the want of authority of the seller.
- The performance of a contract of sale implies delivery of goods by the seller and acceptance of the delivery of goods and payment for them by the buyer, in accordance with the contract.
- Constructive delivery or delivery by attornment takes place when the person in possession of the goods of the seller acknowledges, in accordance with the seller's order that he holds the goods on behalf of the buyer and the buyer has assented to it.
- In case of rejection of goods because of defective delivery the buyer is not bound to return them to the seller, but it is sufficient if he intimates to the seller that he refuses to accept them (Sec. 43).
- The seller of goods is deemed to be an 'unpaid seller' (a) when the whole of the price has not been paid or tendered; or (b) where a bill of exchange or other negotiable instrument has been received as a conditional payment, i.e., subject to the realisation thereof, and the same has been dishonoured.
- The unpaid seller's lien is a possessory lien, i.e., the lien can be exercised as long as the seller remains in possession of the goods. He may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.
- According to Section 51, goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent takes delivery of them.
- It is the duty of the carrier, after receiving due notice, not to deliver the goods to the buyer but to redeliver them to, or according to the directions

of the seller. If by mistake he delivers the goods to the buyer, he can be made liable for conversion. The expenses of redelivery are to be borne by the seller.

- If on a resale there is a loss to the seller, he can recover it from the defaulting buyer. But if there is a surplus on the resale, the seller can keep it with him because the buyer cannot be allowed to take advantage of his own wrong.
- The damages are assessed in accordance with the rules contained in Section 73 of the Indian Contract Act, that is, the measure of damages shall be the estimated loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract.
- The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner, say, by saying words like 'one, two, three' or 'going, going, gone;' and, until such announcement is made, any bidder may retract his bid.

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4.9 KEY WORDS

- **Contract of sale of goods:** It is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.
- **Actionable claims:** It refers to claims which can be enforced by a legal action or a suit, *e.g.,* a book debt (i.e., a debt evidenced by an entry by the creditor in his Account Book).
- **Warranty:** It is a stipulation *collateral* to the main purpose of the contract, the breach of which gives the aggrieved party a right to sue for damages only, and not to avoid the contract itself.
- ***Caveat emptor:*** It means the duty of the buyer to be careful while purchasing goods of his requirement and, in the absence of any enquiry from the buyer, the seller is not bound to disclose every defect in goods of which he may be cognisant.
- **Estoppel:** It means a person who by his conduct or words leads another to believe that certain state of affairs existed, would be estopped from denying later on that such a state of affairs did not exist.

4.10 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the Sale of Goods Act, 1930 and its relevance.
2. Write a brief note on the distinction between 'Sale' and 'Agreement to Sell'.

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3. Write in short about the doctrine of *caveat emptor*.
4. Write in brief about transfer of property in unascertained and future goods.
5. Write a brief note on rights of unpaid seller against the goods.
6. Write a short note on rules relating to an auction sale.

Long-Answer Questions

1. Discuss the essential characteristics of a contract of sale of goods.
2. Analyse the main points of distinction between the 'sale' and 'hire-purchase'.
3. Discuss the various rules of transfer of property.
4. Analyse various modes and rules of delivery of goods.
5. 'It is the duty of the seller to deliver the goods and of the buyer to accept and pay for them in accordance with the terms of the agreement.' Elucidate this statement.
6. Enumerate the rights of the buyer against the seller for breach of contract.

4.11 FURTHER READINGS

Kuchhal, M.C. and Vivek Kuchhal. 2013. *Business Law,* sixth edition. Delhi: Vikas Publishing House.

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BLOCK - II
PARTNERSHIP AND COMPANIES ACT

NOTES

UNIT 5 NEGOTIABLE INSTRUMENTS ACT, 1881

Structure

5.0 INTRODUCTION

The law relating to 'negotiable instruments' is contained in the Negotiable Instruments Act, 1881. The Act extends to the whole of India. The Negotiable Instruments Act, 1881, has been amended more than a dozen times so far. The

latest in the series are: (i) the Banking, Public Financial Institutions and Negotiable Instruments Laws (Amendment) Act, 1988 (effective from 1 April 1989), and (ii) the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 (effective from 6 February 2003). The Negotiable Instruments Act, 1881 as amended, deals with three kinds of negotiable instruments, i.e., Promissory Notes, Bills of Exchange and Cheques. According to Section 4, a promissory note is 'an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument'. Section 5 of the Negotiable Instruments Act defines a bill of exchange as ' an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument'. Section 6 defines a cheque as 'a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form'.

This unit aims at analysing various aspects of negotiable instruments.

5.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand negotiable instruments
- Enumerate the characteristics of negotiable instruments
- Explain the essential requirements of a promissory note
- Learn the essentials of bills of exchange
- Know the distinction between a promissory note and a bill of exchange
- Be familiar with the definitions of a cheque and bank draft
- Learn the distinction between a cheque and a bill of exchange
- Understand negotiation and assignment
- Learn dishonour and discharge of negotiable instruments

5.2 NEGOTIABLE INSTRUMENTS: DEFINITION, NATURE AND TYPES

The word 'negotiable' means 'transferable by delivery', and the word 'instrument' means 'a written document by which a right is created in favour of some person'. Thus, the term 'negotiable instrument' literally means 'a written document transferable by delivery'.

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According to Section 13 of the Negotiable Instruments Act, 'a negotiable instrument means a *promissory note, bill of exchange* or *cheque* payable either to order or to bearer'. 'A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one or two, or one or some of several payees' [Section 13(2)].

The Act, thus, mentions three kinds of negotiable instruments, namely notes, bills and cheques, and declares that to be negotiable they must be made payable in any of the following forms:

1. **Payable to order:** A note, bill or cheque is payable to order which is expressed to be 'payable to a particular person or his order'. For example, (i) Pay *A*, (ii) Pay *A* or order, (iii) Pay to the order of *A*, (iv) Pay *A* and *B*, and (v) Pay *A* or *B* are various forms in which an instrument may be made payable to order. But it should not contain any word prohibiting transfer, e.g., 'Pay to *A* only' or 'Pay to *A* and none else' is not treated as 'payable to order' and therefore, such a document shall not be treated as negotiable instrument because its negotiability has been restricted. It may be noted that documents containing express words prohibiting negotiability remain valid as a document (i.e., as an agreement) but they are not negotiable instruments as they cannot be negotiated further. There is, however, an exception in favour of a cheque. A cheque crossed 'Account Payee only' can still be negotiated further, of course, the banker is to take extra care like a blood-hound in that case.
2. **Payable to bearer:** 'Payable to bearer' means 'payable to any person whosoever bears it'. A note, bill or cheque is payable to bearer which is expressed to be so payable or on which the only or last endorsement is an endorsement in blank. Thus, a note, bill or cheque in the form 'Pay to *A* or bearer', or 'Pay *A*, *B* or bearer', or 'Pay bearer' is payable to bearer. Also, where an instrument is originally 'payable to order', it may become 'payable to bearer' if endorsed in blank by the payee. For example, a cheque is payable to *A*. *A* endorses it merely by putting his signature on the back and delivers it to *B* with the intention of negotiating it (without making it payable to *B* or *B*'s order). In the hands of *B,* the cheque is a bearer instrument.

It is important to note that the above definition is subject to the provisions of Section 31 of the Reserve Bank of India Act, 1934, which as amended by the Amendment Act of 1946, provides as under:

1. No person in India other than the Reserve Bank or the Central Government can make or issue a promissory note 'payable to bearer'.
2. No person in India other than the Reserve Bank or the Central Government can draw or accept a bill of exchange 'payable to bearer on demand'.

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3. A cheque 'payable to bearer on demand' can be drawn on a person's account with a banker. The effect of the above provisions is that:
   (i) A promissory note cannot be *originally* made 'payable to bearer', no matter whether it is payable on demand or after a certain time. It must be made 'payable to order' initially. However, on being endorsed in blank it can become 'payable to bearer' or 'payable to bearer on demand' subsequently and it shall be valid in that case.
   (ii) A bill of exchange may be *originally* made 'payable to bearer' but it must be payable otherwise than on demand (say, payable three months after date) in that case. If it is 'payable on demand' then it must be made 'payable to order'. However, on being endorsed in blank subsequently, it can become 'payable to bearer on demand'.
   (iii) A cheque drawn on a bank can be originally made 'payable to bearer on demand' and it shall be valid. In fact, cheques are always payable on demand.

The object of the above provisions of the Reserve Bank of India Act is to prevent private persons from infringing the monopoly of the Reserve Bank and the Government of Note Issue in India. For, if individuals are allowed to issue instruments 'payable to bearer on demand', then there may be someone so rich and well-known person whose bills of exchange and promissory notes may be taken as currency notes. A currency note bears the words 'I promise to pay the bearer the sum of Rupees 10, 50 or 100, as the case may be. The general public is, therefore, prohibited to issue such notes or bills. Section 32 of the Reserve Bank of India Act, 1934, makes the issue of such bills or notes a criminal offence and declares them illegal and unenforceable at law. Accordingly, 'a promise to pay A or bearer' or 'a promise to pay the bearer' is not enforceable at law and the document containing such a promise is illegal and void.

The definition given in Section 13 of the Negotiable Instruments Act does not set out the essential characteristics of a negotiable instrument. Possibly, the most expressive and all-encompassing definition of negotiable instrument had been suggested by Thomas which is as follows:

> 'A negotiable instrument is one which is, by a legally recognised custom of trade or by law, transferable by delivery or by endorsement and delivery in such circumstances that (a) the holder of it for the time being may sue on it in his own name and (b) the property in it passes, free from equities, to a *bona fide* transferee for value, notwithstanding any defect in the title of the transferor'.

Parties to Negotiable Instrument

The parties to negotiable instrument are as follows:

- **Maker/drawer:** The person who makes or executes the note promising to pay the amount stated therein.

- **Drawee:** The person directed to pay the money by the drawer. The drawee is the paying bank in case of cheque.
- **Payee:** Payee is the person whose name is written on the promissory note or bill of exchange or cheque. The payee is entitled to receive amount mentioned in the note or bill or cheque.
- **Holder:** Holder is either the payee or some other person to whom he may have endorsed the promissory note or bill of exchange or cheque. A person cannot be a holder unless he is the payee or indorsee (endorsee) thereof.
- **Holder in due course:** Holder in due course means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or indorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title."
- **Endorser:** A signature of the owner (the holder of the instrument) would serve the legal rights to transfer an instrument to another party. The holder of the instrument who transfers his right to another party by endorsement is called endorser.
- **Endorsee:** If the endorser adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the person so specified is called the "endorsee" of the instrument.
- **Endorsement:** If the endorser signs his name only, it is called endorsement in blank. If the endorsement contains the instructions of endorser to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is called endorsement in full.
- **Drawee in the case of need:** In addition to drawee's name, the name of a person is given in the bill or endorsement, to have resorted in case of need. Such person is called drawee in case of need.
- **Acceptor for honour:** In the event of refusal of acceptance of bill by the original drawer or in cases of providing better security when demanded by notary public, with the consent of the holder some other person who is originally not liable for payment of bill, may accept it for honour of any party liable on the bill . Such acceptor is called 'Acceptor for honour".

5.2.1 Characteristics of a Negotiable Instrument

An examination of the given definition of negotiable instrument reveals the following essential characteristics of negotiable instruments which make them different from an ordinary chattel. These are as follows:

1. **Easy negotiability:** They are transferable from one person to another without any formality. In other words, the property (right of ownership) in these instruments passes by either both endorsement and delivery (in case it

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is payable to order) or by delivery merely (in case it is payable to bearer), and no further evidence of transfer is needed.

2. **Transferee can sue in his own name without giving notice to the debtor:** A bill, note or a cheque represents a debt, i.e., an 'actionable claim' and implies the right of the creditor to recover something from his debtor. The creditor can either recover this amount himself or can transfer his right to another person. In case he transfers his right, the transferee of a negotiable instrument is entitled to sue on the instrument in his own name in case of dishonour, without giving notice to the debtor of the fact that he has become the holder. In case of transfer or assignment of an ordinary 'actionable claim' (i.e., a book debt evidenced by an entry by the creditor in his account book or *bahi*), under the Transfer of. Property Act, notice to the debtor is necessary in order to make the transferee entitled to sue in his own name, otherwise he has always to join his transferor, i.e., the original creditor before he can recover his claim from the debtor.
3. **Better title to a bona fide transferee for value:** A *bona fide* transferee of a negotiable instrument for value (technically called a *holder in due course*) gets the instrument 'free from all defects'. He is not affected by any defect of title of the transferor or any prior party. Thus, the general rule of the law of transfer of title applicable in the case of ordinary chattels that 'nobody can transfer a better title than that of his own' does not apply to negotiable instruments. A man may sell to another a stolen radio set but the true owner may claim back the radio set from the buyer even though he may have got it in good faith for consideration.
4. **Presumptions:** Certain presumptions apply to all negotiable instruments. These presumptions shall be discussed later in this unit.

5.2.2 Examples and Presumptions of Instruments

i. Examples of negotiable instruments

The following instruments have been recognized as negotiable instruments by statute or by usage or custom: (i) bills of exchange; (ii) promissory notes; (iii) cheques; (iv) government promissory notes; (v) treasury bills; (vi) dividend warrants; (vii) share warrants; (viii) bearer debentures; (ix) port trust or improvement trust debentures; (x) hundis; (xi) railway bonds payable to bearer, etc.

ii. Examples of non-negotiable instruments

These are (i) money orders; (ii) postal orders; (iii) fixed deposit receipts; (iv) share certificates; (v) letters of credit.

iii. Examples of quasi-negotiable instruments

There are some instruments called 'documents of title', e.g., (i) bills of lading; (ii) dock warrants; (iii) railway receipts and (iv) wharfinger certificates, which, like a

negotiable instrument, are capable of being transferred by endorsement and/or delivery, but the transferor of such documents cannot give to the holder any better title to the goods than he himself possesses. Such instruments are termed as 'quasi-negotiable instruments', and the provisions of the Negotiable Instruments Act do not apply to them.

iv. Presumptions as to negotiable instruments

Sections 118 and 119 lay down the following presumptions in respect of negotiable instruments, unless the contrary is proved:

1. That every negotiable instrument was made, drawn, accepted, indorsed or *transferred for consideration*;
2. That every negotiable instrument bearing a date was made or drawn *on such date*;
3. That every bill of exchange was *accepted within a reasonable time* after its date and before its maturity;
4. That every *transfer* of a negotiable instrument was made before its maturity;
5. That the *endorsements* appearing upon a negotiable instrument *were made in the order in* which they appear thereon;
6. That a lost negotiable instrument was *duly stamped*,
7. That the holder of a negotiable instrument is a *holder in due course*; but this presumption would not arise where it is proved that the holder has obtained the instrument from its lawful owner, or from any person in lawful custody thereof, by means of an offence, fraud or for unlawful consideration and in such a case the holder has to prove that he is a holder in due course;
8. That the instrument was dishonoured, in case a suit upon a dishonoured instrument is filed with the court and the fact of 'protest' is proved.

The above presumptions are rebuttable by the defendant.

5.2.3 Promissory Note

According to Section 4, a promissory note is 'an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument'.

Before analysing the essentials of a promissory note as contained in this definition, the following facts are worth noting:

1. A promissory note payable 'only to a particular person' is valid if it satisfies the requirements of the definition, but it shall not be a negotiable instrument within the meaning of the Negotiable Instruments Act as its transferability is restricted. To put it differently, it would appear from the above definition that negotiability is not essential to the validity of a promissory note as an instrument.

2. As observed earlier, under Section 31 of the Reserve Bank of India Act, 1934, no person in India except the Reserve Bank or the Central Government can make or issue a promissory note *payable to bearer*. Accordingly, a promissory note cannot be originally made 'payable to bearer'. Thus, the words 'or to the bearer of the instrument' included in the above definition have become redundant and ineffective. In fact, these words ought to have been deleted after the passing of the Reserve Bank of India Act, 1934.
3. Bank notes (i.e., promissory notes issued by a banker payable to bearer on demand) and currency notes (i.e., promissory notes issued by the Reserve Bank of India or the Central Government payable to bearer on demand) are excluded from the definition of a promissory note because both of them are treated as money. The issue of bank notes, however, is now prohibited by the Reserve Bank of India Act. But Government promissory notes, which are issued by the Government for raising loans, are within the definition.
4. The person who makes the promise to pay is called the 'maker'. He is the debtor and must sign the document. The person to whom payment is to be made (i.e., the creditor) is called the 'payee'.

5.2.4 Essentials of a Promissory Note

From the definition given in the Act, it follows that to be a valid promissory note, an instrument must fulfil the following essential requirements:

1. **It must be in writing:** A promissory note has to be in writing. An oral promise to pay does not become a promissory note. The writing may be on any paper, on any *bahi* or book. It may be in pencil or in ink and includes printing or typing. No particular form of words is necessary, even a promise contained in a letter will suffice, provided the other requirements of Section 4 are complied with. Of course the words used must import a clear undertaking to pay, but it is not necessary that the word 'promise' should be used (*Balmukund vs Munnalal*).

   The following is the usual form of a promissory note:

₹ 1,000	Delhi, 25 July 2004
Sixty days after date I promise to pay to Mr. J.N. Vaish or order the sum of rupees one thousand only with interest thereon at 12 per cent per annum for value received.	
	Revenue Stamp
Sd.	Ram Kishore

Illustrations. *A* signs the instruments in the following terms:

(a) "I promise to pay *B* or order ₹500."

(b) "I acknowledge myself to be indebted to *B* ₹1,000 to be paid on demand, for value received."

Both the above Instruments are valid promissory notes.

2. **It must contain a promise or undertaking to pay:** There must be a promise or an undertaking to pay. The undertaking to pay may be gathered either from express words or by necessary implication. A mere acknowledgement of indebtedness is not a promissory note, although it is valid as an agreement and may be sued upon as such.

   Illustrations. *A* signs the instruments in the following terms:

   (a) 'Mr *B* I.O.U. (I owe you) ₹1,000'.

   (b) 'I am liable to pay to *B* ₹500'.

   (c) 'I have taken from *B* ₹2,000 and I am accountable to him for the same with interest'.

   The above instruments are not promissory notes as there is no undertaking or promise to pay. There is only an acknowledgement of indebtedness.

   Where, however, the acknowledgement of indebtedness contained in the document is in a defined sum of money *payable on demand*, there is a valid promissory note even though the words 'promise to pay' may not have been used. It is so because the phrase 'payable on demand' necessarily implies 'a promise to pay at once or immediately'.

   Illustration. Where *A* signs the instrument in the following terms: 'I, acknowledge myself to be indebted to *B* in ₹1,000, to be paid on demand, for value received', there is a valid promissory note.

3. **The promise to pay must be unconditional:** Certainty is very necessary in the commercial world. As such, a promissory note must contain an unconditional promise to pay. The promise to pay must not depend upon the happening of some uncertain event, i.e., a contingency or the fulfilment of a condition. It must be payable absolutely. If an instrument contains a conditional promise to pay, it is not a valid promissory note and will not become valid and negotiable even after the happening of the condition (*Hill vs Halford*).

   Illustrations. *A* signs the instruments in the following terms:

   (a) I promise to pay *B* ₹500 seven days after my marriage with *C*.

   (b) I promise to pay *B* ₹500 on *D*'s death, provided *D* leaves me enough to pay that sum.

   (c) I promise to pay *B* ₹500 as soon as I can.

   The above instruments are not valid promissory notes as the payment is made dependent upon the happening of an uncertain event which may never happen and as a result the sum may never become payable.

   But a promise to pay is not conditional if the amount is made payable at a particular place or after a specified time or on the happening of an event which must happen, although the time of its happening may be uncertain

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(Sec. 5, para 2). Thus, if *A* signs an instrument stating: 'I promise to pay *B* ₹500 seven days after *C*'s death', the promissory note is valid because it is not considered to be conditional, for it is certain that *C* will die, though the exact time of his death is uncertain.

4. **It must be signed by the maker:** It is imperative that the promissory note should be duly authenticated by the 'signature' of the maker. 'Signature' means the writing or otherwise affixing a person's name or a mark to represent his name, by himself or by his authority with the intention of authenticating a document. The signature may be in any part of the instrument and need not necessarily be at the bottom. The intention to sign, however, must in all cases be proved. It may be in pencil or in ink. When the maker of a pronate is illiterate, his thumb mark is sufficient. But facsimile impressions, whether affixed in printing or by perforation or in some other form, and impressions by a rubber stamp are not recognized as signatures unless the parties specifically agree to treat them as such.
5. **The maker must be a certain person:** The instrument itself must indicate with certainty who is the person or are the persons engaging himself or themselves to pay. In case a person signs in an assumed name, he is liable as a maker because a maker is taken as certain if from his description sufficient indication follows about his identity. Where there are two or more makers, they may bind themselves jointly, or jointly and severally. But alternative promisors are not permitted in law because of the general rule that 'where liability lies no ambiguity must lie'. Thus, a note in the form 'I, Alok Kumar promise to pay' and signed by Alok Kumar or also Satish Chandra is a good note as against Alok Kumar only.
6. **The payee must be certain:** Like the maker the payee of a pronote must also be certain on the face of the instrument. A note is valid even if the payee is misnamed or indicated by his official designation only (Sec. 5, para 4), provided he can be ascertained by evidence. It may be made payable to two or more payees jointly or it may be made payable in the alternative to one of two, or one or some of several payees [Sec. 13(2)]. Thus alternative payees are permissible in law. But it must be made payable to order originally. A note originally made payable to bearer is illegal and void as per Reserve Bank of India Act, 1934. Also, a note in favour of fictitious person is illegal and void, for it is treated as payable to bearer. A pronote made payable to the maker himself is a *nullity*, the reason being the same person is both the promisor and the promisee.
7. **The sum payable must be certain:** For a valid promissory note, it is also essential that the sum of money promised to be payable must be certain and definite. The amount payable must not be capable of contingent additions or subtractions.

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Illustrations. *A* signs instruments in the following terms:

(a) 'I promise to pay *B* ₹500 and all other sums which shall be due to him'.

(b) 'I promise to pay *B* ₹500, first deducting there out any money which he may owe me'.

(c) 'I promise to pay *B* ₹500 and all fines according to rules'.

(d) 'I promise to pay *B* ₹100 on or before 15 August 2004, and a similar sum monthly every succeeding month'.

The above instruments are invalid as promissory notes because the exact amount to be paid by *A* is not certain.

But, according to Section 5, para 3, the sum does not become indefinite merely because:

(i) There is a promise to pay the amount with interest, provided the rate of interest is stated;

(ii) The amount is to be paid at an indicated rate of exchange or according to the course of exchange; or

(iii) The amount is payable by instalments, even with a provision that on default being made in payment of an instalment, the balance unpaid shall become due.

8. **The amount payable must be in legal tender money of India:** A document containing a promise to pay a certain amount of foreign money or to deliver a certain quantity of goods is not a promissory note. Similarly, a promise to deliver paddy either in the alternative or in addition to money does not constitute a promissory note. Thus, an instrument signed by *A*, saying, 'I promise to pay *B* ₹500 and to deliver to him my black horse on 1st January next' is not a valid promissory note.

9. **Other formalities:** Though it is usual and proper to state in a note the place where it is made and the date on which it is made but their omission will not render the instrument invalid. Even where the amount is made payable at a certain time after the date, omission of the date does not invalidate the instrument and the date of execution can be independently ascertained or proved. The words 'value received' are also not an essential part of the form of a pronote, because, as per Section 118, consideration is presumed until the contrary is proved. But a promissory note must be properly stamped as required by the Indian Stamp Act and each stamp must also be duly cancelled. The maker's signature with the date across the stamp cancels the stamp effectively. Although an unstamped or inadequately stamped promissory note is invalid, but the amount of loan can be recovered if proved otherwise.

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5.2.5 Bill of Exchange

Section 5 of the Negotiable Instruments Act defines a bill of exchange as follows:

'A bill of exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument'.

At the very outset the following two facts must be noted:

(i) Although a bill of exchange directing to pay 'only to a particular person' is valid if it satisfies the requirements of the definition but it shall not be a negotiable instrument within the meaning of the Negotiable Instruments Act as its transferability is restricted.

(ii) Although a bill of exchange may be originally drawn 'payable to bearer' but in such a case it must be payable otherwise than on demand (say, three months after date). In other words, a bill cannot be drawn 'payable to the bearer on demand'. If it is 'payable on demand', then it must be made 'payable to order' (Sec. 31 of the Reserve Bank of India Act).

Parties to a bill of exchange: There are three parties to a bill of exchange viz*., drawer, drawee and payee.* The person who makes the bill is called the 'drawer'. The person who is directed to pay is called the 'drawee'. The person to whom the payment is to be made is called the 'payee'. The drawer, or, if the bill is endorsed to the payee, the endorsee, who is in possession of the bill is called the 'holder'. The holder must present the bill to the drawee for his acceptance. When the drawee accepts the bill, by writing the words 'accepted' and then signing it, he is called the 'acceptor'.

It is not necessary, however, that three separate persons should answer to the description of drawer, drawee and payee. One person may fill any two of these positions. Thus, one may become 'drawer and payee' (when the bill is drawn 'Pay to me or my order'), or 'drawee and payee' (when the bill is subsequently endorsed in favour of the drawee), or 'drawer and drawee' (when one draws a bill upon himself). In the last case, the holder may treat the instrument as a bill of exchange or as a promissory note. What is required is that the three parties, *drawer, drawee* and *payee* must be pointed out in the bill with certainty.

Drawee in case of need: Sometimes the name of another person may be mentioned in a bill of exchange as the person who will accept the bill, if the original drawee does not accept it. Since another person so named is to be approached in case of need, he is known as 'drawee in case of need'. (Sec. 7)

Acceptor for honour: When a bill of exchange has been noted or protested for non-acceptance or for better security, and any person accepts it *supra protest* for honour of the drawer or of any one of the indorsers, such person is called an 'acceptor for honour' (Sec. 7). Thus any person may voluntarily become a party to a bill as an 'acceptor for honour'.

Now let us explain some other aspects of a bill of exchange. These are:

A. Essentials of a bill of exchange

To be a valid bill of exchange an instrument must comply with the requirements of the definition given in Section 5, which are as follows:

1. It must be in *writing*.
2. It must contain an *order to pay*. A mere request to pay on account will not amount to an order. But an order may be expressed in polite language.
3. The order to pay must be unconditional.
4. It must be *signed by the drawer*.
5. *The drawer, drawee and payee must be certain.* A bill cannot be drawn on two or more drawees in the alternative because of the rule of law that 'where liability lies, no ambiguity must lie'. But a bill may be made payable in the alternative to one of two or more payees (Sec. 13).
6. The *sum payable must be certain.*
7. The bill must contain an order to pay *money only.*
8. It must comply with the formalities as regards date, consideration, stamps, etc.

It will be seen that the fundamental essentials of a bill enumerated above are more or less similar to that of a promissory note. As such the rules that apply to promissory notes in regard to those essentials are in general applicable to bills of exchange as well. (For details of these essentials, see notes to promissory note.)

B. Special benefits of bill of exchange

The special benefits of using bills of exchange in the world of commerce are as follows:

1. A bill of exchange is a double secured instrument. If the bill is dishonoured by the acceptor, the holder or the payee may look to the drawer of the bill for payment.
2. In case of immediate need of money, a bill can be discounted with a bank by the payee.
3. Two separate trade debts can be discharged by a bill of exchange. Hence, where *A* buys goods on credit from *B* for ₹1,000 to be paid three months after date and *B* buys goods on credit from *C* on similar terms for similar amount, an order by *B* to *A* to pay the sum of ₹1,000 to *C* will discharge two separate trade debts.

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C. Specimen of a bill of exchange

₹ 1,000 New Delhi, 25 August 2004

Three months after date pay to C or order the sum of rupees one thousand only, for value received.

To

A

135 Sadar Bazar

Delhi

Accepted

Sd/- A

Sd/-

Revenue Stamp

B

5.2.6 Distinction Between a Promissory Note and a Bill

The points of distinction between a promissory note and a bill of exchange are as follows:

1. **Number of parties:** In a promissory note there are two parties: (*i*) the maker of the note and (*ii*) the payee. In a bill of exchange, there are three parties: (*i*) the drawer, (*ii*) the drawee and (*iii*) the payee.
2. **The maker of a note cannot be the payee:** In the case of a promissory note, the maker cannot be the payee for the simple reason that the same person cannot be both the promisor and the promisee. But in a bill of exchange, the drawer and the payee may be one and the same person as where a bill is drawn 'Pay to me or my order'.
3. **Promise and order:** In a promissory note, there is a promise to make the payment, whereas in a bill of exchange there is an order for making the payment.
4. **Acceptance:** A promissory note requires no acceptance as it is signed by the person who is liable to pay. The drawer of a bill of exchange is generally the creditor of the drawee, and therefore it must be accepted by the drawee before it can be presented for payment.
5. **Nature of liability:** The liability of the maker of a pronote is primary and absolute but the liability of a drawer of a bill of exchange is secondary and conditional. It is only when the acceptor does not honour the bill that the liability of the drawer arises as a surety. (Sections 30 and 32)
6. **Maker's position:** The maker of a promissory note stands in immediate relation with the payee, while the maker or drawer of an accepted bill stands in immediate relation with the acceptor and not the payee (Explanation to Sec. 44).

   The position of the maker of a pronote also differs from the position of the acceptor of a bill. A promissory note must contain an unconditional promise to pay and therefore the maker, who himself is the originator of a note, cannot make it conditional. In the case of a bill of exchange although the

drawer, who is the originator of a bill, has to make an unconditional order to pay but under Section 86 the acceptor may accept the bill conditionally.

7. **Payable to bearer:** A promissory note cannot be drawn 'payable to bearer', while a bill of exchange can be so drawn provided it is not drawn 'payable to bearer on demand'.
8. **Notice of dishonour:** In case of dishonour of a bill of exchange, notice of dishonour must be given by the 'holder' to all prior parties who are liable to pay (including the drawer and endorsers), whereas in case of dishonour of a promissory note, no notice is necessary to the maker.
9. **Applicability of certain provisions:** The provisions relating to presentment for acceptance, acceptance, acceptance *supra protest* and drawing of bills in sets are applicable only to a bill of exchange, they are not applicable to a promissory note.

It is essential to understand some other bills. These are:

i. Accommodation bill

An accommodation bill is apparently quite similar to an ordinary trade bill of exchange. The special feature which distinguishes it from an ordinary bill is that such a bill is not supported by any consideration or a trading transaction. The drawer does not give any consideration to the drawee but instead it is drawn with an object of providing financial help either to the drawer or to both the drawer and the drawee. Thus, the relationship between the drawer and the drawee is not that of a creditor and a debtor in the case of an accommodation bill. Actually, it is a sort of mercantile credit where one person lends out his name on the bill so that the other person taking the bill can get the same discounted from the bank and get money for the same. Since such bills are drawn and accepted without any consideration with a view to accommodating or obliging friends, they are rightly termed as 'accommodation bills'.

Illustration: *P* desires to have ₹5,000 for three months and approaches *Q* for that purpose. *Q* has no funds in hand but has credit in the market. *Q* agrees to help *P*. It is arranged, therefore, that *P* will draw a bill on *Q* for ₹5,000 payable after three months and *Q* will accept the bill. *P* can discount the bill with his bankers and get the money or can negotiate the bill in discharge of his debt. Before the maturity of the bill, *P* will provide *Q* with funds sufficient to meet it. Thus *P* is able to get the required funds for three months. Such a bill is called an 'accommodation bill'.

The party accommodating (i.e., *Q*) is called the 'accommodation party' and the party accommodated (i.e., *P*) is called the 'accommodated party'.

Sometimes a party may be accommodated by endorsing an existing bill with consideration. Such an endorser is called the 'backer' and the operation is called 'backing the bill'.

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The Negotiable Instruments Act lays down the following rules regarding accommodation bill:

1. An accommodation bill creates no obligation of payment between the parties to the transaction. In other words, the accommodation party is not liable on the bill to the accommodated party on maturity date, if the bill is in the hands of the accommodated party because of subsequent indorsement in his favour, or if the bill has been paid by the accommodated party (i.e., the drawer) on its dishonour by the acceptor (i.e., the accommodation party), as the contract between them is not based on any consideration. (Sec. 43)
2. The accommodation party is liable on the bill to any subsequent 'holder for value'. even if such a holder knew at the time of taking the bill that it is an accommodation bill (Sec. 43). Of course, the accommodation party is entitled to recover from the accommodated party whatever he pays on the bill.
3. An accommodation bill can be negotiated after maturity (i.e., when it becomes overdue), with all benefits of a 'holder in due course' to the transferee (i.e., the transferee acquiring a better title than the transferor) (Sec. 59). (The transferee of an overdue ordinary bill of exchange gets no better title than his transferor as he cannot be a 'holder in due course'. Section 9 provides that a 'holder in due course' should acquire the instrument before maturity).
4. Non-presentation of an accommodation bill to the acceptor for payment does not discharge the drawer. [Section 76 (d) provides that presentation is not necessary when drawer could not suffer damage]. It is an exception to the general rule contained in Section 64 whereby a bill must be presented for payment to the acceptor by the holder otherwise other parties thereto are not liable thereon to such a holder.
5. When an accommodation bill is dishonoured, failure to give notice of dishonour does not discharge the liability of prior parties, as it does in the case of an ordinary bill [Sec. 98 (c)].

ii. Fictitious bill

When in a bill of exchange the names of both the drawer and the payee are fictitious, the bill is said to be a fictitious bill. Such a bill is drawn in a fictitious name and is made payable to the drawer's order and as such the names of both the drawer and the payee are said to be of a fictitious person. A fictitious person is one who has no existence, i.e., who is imaginary. If a real existing person's name is forged as drawer and payee, then the bill is a 'forged bill', which is a nullity and confers no title even to a holder in due course. In a forged instrument there is complete absence of title as distinct from defect of title.

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A fictitious bill even if accepted by a genuine person is not a good bill and cannot be enforced by law. However, such a bill, if accepted by a genuine person, becomes a good bill in the hands of a holder in due course provided he can show that the first indorsement on the bill and the signature of the supposed drawer (being the holder as well) are in the same handwriting, and the acceptor is liable on the bill to him (Sec. 42).

ii. Documentary bill

When documents relating to the goods represented by the bill, e.g., bill of lading or railway receipt, invoice, marine insurance policy, etc., are attached to a bill, the bill is called a documentary bill. Such documents are delivered to the buyer only on acceptance or payment of the bill. Such bills are usually used in foreign trade. In inland trade, generally 'clean bills' are used with which no other documents are attached.

5.2.7 Cheque

Section 6, as substituted by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 defines a cheque as follows:

'A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form'.

'Explanation I: For the purposes of this Section, the expression:

(a) 'a cheque in the electronic form' means a cheque which contains the exact mirror image of a paper cheque, and is generated, written and signed in a secure system ensuring the minimum safety standards with the use of digital signature (with or without biometrics signature) and asymmetric crypto system;

(b) 'a truncated cheque' means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing.

Explanation II: For the purposes of this Section, the expression 'clearing house' means the clearing house managed by the Reserve Bank of India or a clearing house recognised as such by the Reserve Bank of India'.

Thus, a cheque is a bill of exchange with two distinctive features, namely:

(i) It is always drawn on a bank, and

(ii) It is always payable on demand.

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Specimen of a cheque



5.2.8 Distinction Between a Cheque and a Bill of Exchange

A cheque, being, a species of a bill of exchange, must satisfy almost all the essentials of a bill, e.g., signed by the drawer, containing an unconditional order to pay a certain sum of money, to the order of a person or the bearer, etc. Yet there are few points of difference between the two, namely:

CHEQUE	BILL OF EXCHANGE
Cheque is always supposed to be drawn by a banker	Bill of exchange may be drawn on any person, including a banker
Cheque can only be drawn payable on demand	Bill of exchange can be drawn payable to demand or on the expiry of a certain period after date or site
A cheque drawn ‘payable to bearer on demand’ is valid	Bill of exchange drawn ‘payable to bearer on demand’ is absolutely void and illegal
Cheque does not require acceptance by the drawee before payment can be demanded.	Bill of exchange requires acceptance by the drawee before he can be made liable upon it.
Cheque does not require any stamp	Bill of exchange needs to be properly stamped
Number days of grace are allowed in the case of cheque as it is always payable on demand	Three days of grace are allowed while calculating the maturity date in the case of time bills, i.e., bills drawn after expiry
Cheques can be crossed	Bills of exchange cannot be crossed
There is no system of noting or protest in cheques	There is a system of noting and protest in bills of exchange
Payment of cheque can be countermanded by drawer	Payment of bills of exchange cannot be countermanded by the drawer
Drawer of cheque will not be discharged from liability in case of delay of the older in presenting it for payment.	The drawer of bills of exchange is discharged from liability

5.2.9 Bank Draft

A **bank draft** is an order issued by one bank on another bank or on its own branch (usually drawn on its own branch) instructing the latter to pay a specified sum of money to a specified person or his order. It is a negotiable instrument and is very much like a cheque, with the following distinctions:

(a) It can be drawn only by a bank on another bank or on its other branch and not by an individual as in the case of a cheque.

(b) It cannot so easily be countermanded as a cheque.

(c) It cannot be made payable to bearer.

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5.2.10 Miscellaneous Provisions

A. Time and demand instruments

An instrument payable after a fixed time (say, after three months) or on a specified date (say, on 25 August 2004) is termed as a '*time instrument*'. An instrument payable after the happening of an event which is certain to happen, e.g., death, though the time of its happening may be uncertain, is also called a *time instrument*. In the case of *time instruments,* the period of limitation begins to run from the maturity date. It may be noted that there can be a 'time bill' or a 'time note' but not a 'time cheque', the reason being that a cheque cannot be expressed to be payable otherwise than on demand.

An instrument payable *on demand* or *at sight* (i.e., on presentation in case of a cheque or a promissory note, and on acceptance in case of a bill of exchange) is termed as a 'demand instrument'. Again, a promissory note or a bill of exchange in which no time for payment is specified is also a *demand instrument* (Sec. 19). In case *of demand instruments,* the period of limitation begins to run from the date of their execution except where they are made payable 'at sight' in which case the period of limitation commences from the date of presentation.

B Ambiguous Instruments

An instrument, which in form is such that it may either be treated as a bill of exchange or as a promissory note, is an ambiguous instrument. In such a case, the holder may either treat it as a bill of exchange or a promissory note, but once he has made his choice, the instrument shall henceforth be treated accordingly. (Sec. 17).

The following are the examples of ambiguous instruments:

1. Where in a bill the drawer and the drawee are the same person. Thus, where a bill is drawn by an agent, acting within the scope of his authority, upon his principal, the holder may, at his option, treat it as a note or a bill because the drawer and the drawee are the same person in the eye of law. But where drawer and payee are the same, e.g., where a bill is drawn payable to the drawer's order, it is not an ambiguous instrument and is a valid bill of exchange.
2. Where in a bill the drawee is a fictitious person or a person not having the capacity to contract. Thus, where *P* draws a bill on *Q* and negotiates it away, and *Q* is a fictitious or a minor drawee, the holder may treat the bill as a note made by *P*.

C Inchoate instruments

An incomplete or blank negotiable instrument properly stamped and signed is termed as an 'inchoate instrument'. Section 20 deals with inchoate stamped instruments and provides that 'where one person signs and delivers to another a

paper stamped in accordance with the law relating to negotiable instruments, either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount. But a person other than a holder in due course cannot recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder'.

It is to be emphasized that *delivery* of a *stamped paper* to *the holder* is necessary for the application of this Section, otherwise the maker or acceptor will not be liable even to a subsequent holder in due course. Where, for example, a person signed a blank acceptance and kept it in his drawer, and some person stole it and filled it up for ₹1,500 and negotiated it to an innocent person for value, it was held that the signer to the blank acceptance was not liable to the holder in due course because he never delivered the instrument intending it to be used as a negotiable instrument (*Baxendale vs Bennett*).

It is also important to note that although the Section makes the person signing and delivering the inchoate instrument liable to a 'holder' as well as to a 'holder in due course', but there is a difference in their respective rights. A 'holder' can recover only what the signer intended to be paid under the instrument, while a 'holder in due course' can recover the whole amount made payable by the instrument provided that it is covered by the stamp, even though the amount authorised was smaller.

Illustration: *P* owes *Q* some money on account of credit purchases made by him. *P* gives a promissory note, after affixing one rupee revenue, stamp and signing, leaving the amount blank to *Q* authorizing him to fill it up in accordance with the account. *Q* fills '450 while actual amount due is ₹300 only. *Q* cannot recover more than ₹300. But if *Q* transfers it to *R*, a holder in due course, *R* can recover ₹450, the full amount, from *P*. If, however, the amount filled in by *Q* is ₹5,200; *R* cannot recover it, for the amount is not covered by the stamp.

D Escrow

When a negotiable instrument is endorsed and delivered conditionally or for a special purpose only, e.g., as collateral security or for safe custody, and not for the purpose of absolutely transferring property therein, it is called an **escrow**. In this case, the property in the instrument does not pass to the endorsee, and he is merely a bailee with limited title and power of negotiating it. This, however, does not affect the rights of a holder in due course.

5.2.11 Maturity Of Negotiable Instruments

'Maturity' means the date on which the payment of an instrument falls due. An instrument payable on demand or at sight such as a cheque becomes payable

immediately on the date of its execution and there is no question of its maturity. Its payment falls due at once on the date of its issue. The question of maturity, therefore, arises only in the case of a promissory note or a bill of exchange which is expressed to be payable otherwise than on demand.

Every promissory note or bill of exchange expressed to be payable on a specified day, or at a certain period after date or after sight, or at a certain period after the happening of an event which is certain to happen is at maturity on the third day after the day on which it is expressed to be payable (Sec. 22). A time bill or note is as such entitled to *three days of grace* and matures or falls due on the last day of grace (and not on the date on which it is expressed to be payable). For example, a bill of exchange drawn on 1 January, if expressed payable three months after date, is at maturity on 4 April. Such a bill or note must be presented for payment only on the last day of grace, and if dishonoured, the suit can be filed on the next day after maturity. Any presentment for payment earlier to the third day of grace is invalid, even if the word 'punctually' is added to a fixed date.

5.2.12 Rules for Calculating Maturity

Sections 23 to 25 lay down the following rules for calculating the maturity of a time bill or note:

1. If it is made payable *a stated number of months* after date or after sight, or after a certain event, it matures (or becomes payable) three days after the corresponding date of the month after the stated number of months.

   Illustration: A negotiable instrument, dated 30 August 1977, is made payable three months after date. The instrument is at maturity on 3 December 1977. [See Illustration (b) to Section 23]

2. If the month in which the period would terminate has no corresponding date, the period shall be held to terminate on the last day of such month.

   Illustrations:

   (a) A negotiable instrument dated 30 January 1977, is made payable at one month after date. The instrument is at maturity on the third day after 28 February 1977 (i.e., 3 March 1977) [See Illustration (a) to Section 23].

   (b) A promissory note or bill of exchange, dated 31 August 1977, is made payable three months after the date. The instrument is at maturity on 3 December, 1977 [See Illustration (c) to Section 23].

3. If it is made payable *a certain number of days* after date or after sight, or after a certain event, the maturity is calculated by excluding the day on which the instrument is drawn or presented for acceptance or sight or on which the event happens. Note that only one day is to be excluded.

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Illustrations:

(a) A bill of exchange dated 1 March, is made payable 20 days after date. The period of 20 days will be counted from 2 March, and the bill will be at maturity on 24 March.

(b) A bill of exchange, dated 1 January, and payable 20 days after sight, is presented for acceptance on the 5 January. The bill shall mature on 28 January.

4. If the date on which a bill or note is at maturity is a public holiday, the instrument shall be deemed to be due on the next preceding business day. The expression 'public holiday' includes Sundays and any other day declared by the Central Government, by notification in the Official Gazette, to be a public holiday. Thus, if the maturity of an instrument falls on Sunday, it shall be deemed to be due on Saturday. If the maturity falls on an emergency holiday, the instrument shall be deemed to be due on the next succeeding business day.
5. If an instrument is payable by instalments, three days of grace are to be allowed on each instalment (Sec. 67).

5.2.13 Payment in Due Course

The payment of the amount due under a negotiable instrument must amount to 'payment in due course' in order to operate as a valid discharge of the instrument against the holder. Section 10 provides that in order to constitute a payment of a negotiable instrument as a 'payment in due course', the following conditions must be fulfilled:

1. *The payment must be in accordance with the apparent tenor of the instrument:* It should be made at or after maturity. A payment before maturity is not a payment in due course so as to discharge the instrument. Thus, if a bill of exchange is paid before the last day of grace and is subsequently indorsed over, it is valid in the hands of a holder in due course and the acceptor will be liable to pay again on the instrument. Similarly, if the banker makes payment of a post-dated cheque before the date mentioned therein, he acts against the apparent tenor of the instrument i.e., against the true intentions of the drawer and hence the payment will not be treated as payment in due course.
2. *The payment must be made in good faith and without negligence:* It must be honestly made in the *bona fide* belief that the person demanding payment is legally entitled to it. The payer must not be guilty of any negligence in making the payment. If there are suspicious circumstances and the payer fails to make necessary inquiry which may reveal the defects, the payment is not a payment in due course. Thus, if a specially endorsed bill of exchange is paid without inquiry as to the payee or if a cheque with forged signature

of the drawer is paid, it will amount to negligence on the part of the payer and the payment will not be treated as payment in due course.

3. *The payment must be made to a person in possession of the instrument* under circumstances which do not arouse suspicion about his title to possess the instrument and to receive payment of the amount therein mentioned. A payment cannot be a payment in due course if it is made without requiring production of the instrument and, therefore, the payer must insist on seeing the instrument before making the payment and must obtain the instrument on payment.
4. *The payment must be made in money only*, unless the holder agrees to accept payment in any other medium or by cheque or draft.

To sum up, 'payment in due course' implies payment: (i) according to the apparent tenor of the instrument at or after maturity (ii) in good faith and without negligence (iii) in money (or by cheque if acceptable to the holder) (iv) to a person who is legally entitled to the instrument and is in possession of the same.

5.2.14 Payment of Interest

The Negotiable Instruments Act lays down the following provisions regarding the payment of interest:

1. **When rate specified:** When interest at a specified rate is expressly made payable on a promissory note or bill of exchange, interest shall be calculated at the rate specified, on the amount of the principal money due thereon, from the date of the instrument, until tender or realization of such amount, or until such date after the institution of a suit to recover such amount as the Court directs (Sec. 79).
2. **When no rate specified:** When no rate of interest is specified in the instrument, or when no mention is made of interest at all, interest on the amount due thereon shall, notwithstanding any oral agreement relating to interest between any parties to the instrument, be calculated at the rate of 18 per cent per annum, from the date at which the same ought to have been paid by the party charged, until tender or realization of the amount due thereon, or until such date after the institution of a suit to recover such amount as the Court directs (Sec. 80).
3. When the party charged is the indorser of an instrument dishonoured by non-payment, he is liable to pay interest only from the time that he receives notice of the dishonour (Explanation to Section 80).

5.2.15 Holder

The 'holder' of a negotiable instrument means any person entitled to possess the instrument in his own name and to receive or recover the amount due thereon from the parties liable thereto (Sec. 8). Thus, in order to be called a 'holder', a person must satisfy the following two conditions:

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1. *He must be entitled to the possession of the instrument in his own name:* Actual possession of the instrument is not essential. What is required is a right to possession under some legal or valid title. He should be a '*de jure* holder' and not necessarily a '*de facto* holder'. It means that the person must be named in the instrument as the payee or the indorsee, or he must be the bearer thereof, if it is a bearer instrument. However, the heir of a deceased holder or any other person becoming entitled by operation of law is a holder although he is not the payee or indorsee or bearer thereof.

   If a person is in possession of a negotiable instrument without having a right to possess the same, he cannot be called the holder. Thus, although a thief, or a finder on the road, or an indorsee under a forged indorsement, may be having the possession of the instrument, he cannot be called its holder because he does not acquire legal title thereto and hence is not entitled in his own name to the possession thereof. Similarly, a beneficial owner claiming through a *benamidar* in whose favour the instrument had been made or drawn is not a holder because he is not entitled to the possession in his own name and cannot by himself maintain an action on the instrument (*Subba Narayana vs Ramaswami*).

2. *He must be entitled to receive or recover the amount due thereon from the parties liable thereto:* In order to be called a holder, besides being entitled to the possession of the instrument in his own name, the person must also have the right to receive or recover the amount of the instrument and give a valid discharge to the payer. Thus, one may be the bearer or the payee or indorsee of an instrument but he may not be called a holder if he is prohibited by a court order from receiving the amount due on the instrument.

It may, thus, be concluded that both the above conditions must be satisfied by a person to be called a holder. For instance, where an instrument payable to order is, without endorsement, entrusted by the payee to his agent, the agent does not become the holder of it, although he may receive its payment, because he has no right to sue on the instrument in his own name.

The holder of a negotiable instrument is a very important party to the instrument as such. It is he alone who can sue upon a negotiable instrument, can negotiate it (with certain exceptions) and can give a valid discharge for it.

Check Your Progress

1. What do you mean by the term 'negotiable instruments'?
2. List some examples of negotiable instruments.
3. What are 'quasi-negotiable instruments'?
4. List the essentials of a 'promissory note'.
5. What are the essential characteristics of a 'bill of exchange'?
6. What is an 'ambiguous instrument'?

5.3 NEGOTIATION

Easy transferability being one of the essential features of negotiable instruments, they are frequently transferred from one person to another for making payment and discharging business obligations. Generally, the person who is entitled to receive the payment of a negotiable instrument (i.e., the holder) does not retain it till maturity but transfers it to one of his creditors in payment of his debt, who in turn again transfers it to his creditor and so on. The ownership of a negotiable instrument continues to be transferred from one to another. This process of transferring the title or ownership of negotiable instruments is called 'negotiation'.

5.3.1 Negotiation

According to Section 14, 'when a promissory note, bill of exchange or cheque is transferred to any person, so as to constitute that person the holder thereof, the instrument is said to be negotiated'. Thus, negotiation implies a transfer of negotiable instrument so as to constitute the transferee a holder thereof, who should be entitled in his own name to sue on the instrument and recover the amount due thereon. Handing over a bearer instrument to a servant for safe keeping is not negotiation; there must be a transfer with intention to pass title and in the manner prescribed by the Act.

Every maker, drawer, payee or indorsee, and if there are several makers, drawers, payees or indorsees, all of them jointly can negotiate an instrument, provided the negotiability of such instrument has not been restricted or excluded by any express words used in the instrument. But the maker, drawer, payee or indorsee cannot negotiate an instrument, unless he is in lawful possession or is holder thereof (Sec. 51). The case when a maker or drawer has to indorse an instrument arises where the instrument is made or drawn payable to his own order, e.g., 'pay to myself or order'.

A negotiable instrument may be negotiated until payment or satisfaction thereof by the maker, drawee or acceptor at or after maturity, but not after such payment or satisfaction (Sec. 60). Thus, negotiability of an instrument stops only when the party ultimately liable thereon pays it at or after maturity. It can be negotiated even at or after maturity if it has not been paid or satisfied. A payment before maturity does not stop negotiability. The acceptor or maker who receives the instrument after payment but before maturity may reissue it.

5.3.2 Distinction between Negotiation and Assignment

The Negotiable Instruments Act does not prohibit transfer of negotiable instruments otherwise than by negotiation. The equitable title to the instrument may also be transferred by '*assignment*' by a separate deed in writing, in accordance with the Transfer of Property Act. The various points of distinction between negotiation and assignment are stated below:

1. **Formalities:** Negotiation requires mere 'delivery' of a 'bearer' instrument and 'indorsement and delivery' of an 'order' instrument to effectuate a transfer. Assignment requires a written document signed by the transferor irrespective of whether the instrument is a 'bearer' or 'order' one.
2. **Notice of transfer:** In the case of assignment, a notice of transfer of debt is required to be given by the assignee to the debtor in order to complete his title. No such notice is required to be given in the case of negotiation.
3. **Title:** In the case of negotiation, if the transferee takes the negotiable instrument for value and in good faith, i.e, as holder in due course, he takes it free from all defects in the title of the previous transferors. But in the case of assignment, the assignee takes the instrument subject to the defects in the title of his assignor, even though he took the assignment for value and in good faith.
4. **Consideration:** Consideration is always presumed in the case of transfer by negotiation, whereas there is no such presumption in the case of transfer by assignment, where the burden of proof of consideration lies upon the assignee.

From the foregoing differences, it will be seen that the rights which the transferee of a negotiable instrument by negotiation acquires are substantially superior to those of an assignee under assignment, and it is for this reason that the method of transfer by assignment is very rarely used while transferring negotiable instruments.

5.3.3 Modes of Negotiation

There are two ways of negotiating or transferring a negotiable instrument:

1. **Negotiation by mere delivery:** A negotiable instrument payable to bearer is negotiable by delivery thereof (Sec. 47). Thus, a bearer instrument may be negotiated by delivery only. It does not require signature of the transferor (i.e., indorsement) and the transferee becomes the holder thereof by mere possession. The transferor of a bearer instrument is not liable on its dishonour because by not signing as indorser he has not added his credit to the instrument.
2. **Negotiation by indorsement and delivery;** A negotiable instrument payable to order is negotiable by the holder by indorsement and delivery thereof (Sec. 48). Thus, the negotiation of an order instrument requires two formalities—first the holder should indorse it and then deliver to his indorsee.

Check Your Progress

7. Who can negotiate an instrument?
8. List the modes of negotiation.

5.4 DISHONOUR AND DISCHARGE OF NEGOTIABLE INSTRUMENTS

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A negotiable instrument may be dishonoured by: (i) non-acceptance or (ii) non-payment. As presentment for acceptance is required only in case of bills of exchange, it is only the bills of exchange which may be dishonoured by non-acceptance. Of course any type of negotiable instrument—promissory note, bill of exchange or cheque—may be dishonoured by non-payment. There are various aspects of dishonour. These are:

i. Dishonour by non-acceptance

A bill of exchange is said to be dishonoured by non-acceptance in the following cases:

1. When the drawee or one of several drawees (not being partners) makes default in acceptance upon being duly required to accept the bill. It may be recalled that the drawee may require 48 hours' time (exclusive of public holidays) to consider whether he will accept or not (Sec. 63).
2. Where the presentment for acceptance is excused and the bill is not accepted, i.e., remains unaccepted.
3. Where the drawee is incompetent to contract.
4. Where the drawee makes the acceptance qualified.
5. If the drawee is a fictitious person or after reasonable search cannot be found (Sec. 61).

It is important to note that where a 'drawee in case of need' is named in a bill of exchange, the bill is not dishonoured until it has been dishonoured by such drawee (Sec. 115).

ii. Dishonour by non-payment

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same (Sec. 92). Also, a promissory note or bill of exchange is dishonoured by non-payment when presentment for payment is excused expressly by the maker of the note or acceptor of the bill and the note or bill remains unpaid at or after maturity (Sec. 76).

iii. Effect of dishonour

As soon as a negotiable instrument is dishonoured (either by non-acceptance or by non-payment) the holder becomes entitled to sue the parties liable to pay thereon. The drawer of cheque, maker of note, acceptor and drawer of bill and all the indorsers are liable severally, and jointly to a holder in due course. The holder

must, however, give 'notice of dishonour' to all parties against whom he intends to proceed. He *may* (at his option) also have the instrument 'noted and protested' before a notary public.

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iv. Notice of dishonour

Notice of dishonour means formal communication of the fact of dishonour. It is given to the party sought to be made liable and, therefore, it serves as a warning to the person to whom the notice is given that he could now be made liable. Such a notice also serves the purpose of enabling the person so notified to protect himself against his prior parties.

a. **Notice by whom?** Notice of dishonour must be given by the holder or by some party to the instrument who remains liable thereon (Sec. 93). Further, any party receiving notice of dishonour must also transmit the same within a reasonable time to all prior parties in order to render them liable to himself. He cannot sue any prior party to whom he has not transmitted the notice unless that party has received due notice from the holder or some other party to the instrument (Sec. 95). It may be noted that where a number of persons are required to give notice to certain persons it is not necessary that all of them must give the notice. If some of them have given notice of dishonour, the other persons can take advantage of the same.

   Notice of dishonour can also be given by the duly authorized agent of the person who is bound to give notice. When an instrument is deposited with an agent for presentment and is dishonoured the agent can himself give notice to prior parties on behalf of the holder. But it is not obligatory on him to do so. He may give notice to his principal within the same time as if he were the holder and the principal may then give notice to parties to whom he wants to hold liable. The principal is also entitled to a further like period to give notice of dishonour (Sec. 96).

b. **Notice to whom?** Notice of dishonour must be given to all parties (other than the maker of a note, acceptor of a bill or drawee of a cheque) to whom the holder seeks to make liable or to their duly authorized agents. Where there are two or more persons jointly liable as drawers or indorsers, notice to any one of them is sufficient. No notice need be given to the maker of a note, or acceptor of a bill or drawee of a cheque who are the principal debtors and have themselves dishonoured the instrument (Sec. 93). In case of death of a person, notice must be given to his legal representative, or, where he has been declared an insolvent, it must be given to his Official Assignee (Sec. 94). When the party to whom notice of dishonour is despatched is dead, but the party despatching the notice is ignorant of his death, the notice is sufficient to bind the estate of the deceased (Sec. 97). Thus if the fact of death is known to the holder, a notice addressed

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to the dead person is a nullity. In such a case, notice must be addressed to his legal representative.

c. **Mode of giving notice:** According to Section 94 the notice of dishonour may be oral or written. If it is written it may be sent by post. A notice duly addressed and posted is good even though it may be miscarried. The notice may be in any form but the language used must indicate that the instrument has been dishonoured and in what way dishonoured, and that the recipient will be held liable thereon. It should be given within a *reasonable time* after dishonour, at the place of business or (in case such party has no place of business) at the residence of the party for whom it is intended.

d. **What is reasonable time?** In determining what is a reasonable time for giving notice of dishonour, regard shall be had to the nature of the instrument, the usual course of dealing with respect to similar instruments and the distance between the parties, and, in calculating such time, public holidays shall be excluded (Sec. 105). Section 106 further provides that if the holder and the party to whom notice of dishonour is given carry on business or live (as the case may be) in different places, such notice shall be deemed to be given within a reasonable time if it is despatched by the next post or on the day next after the day of dishonour. If the said parties carry on business or live in the same place, such notice is within reasonable time if it is despatched in time to reach its destination on the day next after the day of dishonour.

If a party who receives the notice of dishonour is to transmit the same to his own prior parties, the transmission is within reasonable time if he transmits it within the same time *after its receipt* as he would have had to give notice if he had been the holder (Sec. 107).

e. When a notice of dishonour is unnecessary: Notice of dishonour is not necessary, i.e., the parties are liable without any notice of dishonour in the following cases mentioned in Section 98:

1. When it is dispensed with by the party entitled to the notice. For example, where the indorser while signing in that capacity adds the words 'notice of dishonour waived', no notice of dishonour is required.
2. When the drawer of a cheque has countermanded payment, no notice of dishonour is required to charge the drawer.
3. When the party charged could not suffer damage for want of notice. For example, when the cheque is dishonoured because the drawer had closed his account with the banker, or in case of accommodation bills, no notice of dishonour to the drawer is required.
4. When the party entitled to notice cannot, after due search, be found; or the party bound to give notice is, because of some justifiable reason (e.g., death, accident or serious illness), unable to give it.

5. When the drawer also happens to be the acceptor.
6. In the case of a promissory note which is not negotiable. Since such a note is not negotiable, the payee ought not to indorse it, and if it is indorsed, the indorsee cannot have any claim against the maker of the note or the indorser. Therefore, no one is prejudiced for want of notice.
7. When the party entitled to notice promises to pay unconditionally the amount due on the instrument after dishonour and with full knowledge of facts.

f. **Consequences of not giving notice of dishonour:** Any party to a negotiable instrument (other than the maker of a note, acceptor of a bill or drawee of a cheque) to whom notice of dishonour is not sent by the holder is discharged from his obligation under the instrument and cannot be sued by the holder, unless the circumstances are such that no notice of dishonour is required to be sent. The drawer or indorser who has not received notice is discharged not only on the bill or note but also in respect of the original consideration (*Mohd. Raffi vs Qazi Mazhar*).

5.4.1 Noting or Notice of Dishonour

'Noting' is the authentic and official proof of presentment and dishonour of a negotiable instrument. The question of noting does not arise in the case of dishonour of a cheque because in such a case the bank, while refusing payment, returns back the cheque giving reasons in writing for the dishonour of the same, and that itself acts as an authentic evidence of the fact of dishonour. Even in the case of inland bills or notes, noting is not compulsory (Sec. 104).

According to Section 99, when a promissory note or a bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a Notary Public upon the instrument, or upon a paper attached thereto, or partly upon each. For this the holder takes the bill or note to the notary public who makes a demand for acceptance or payment upon the drawee or acceptor or maker formally and on his refusal to do so notes the same on the bill or note. Thus 'noting' means recording the fact of dishonour on the dishonoured instrument or on a paper attached thereto for the purpose. Noting must be made within a reasonable time after dishonour and must specify: (i) the date of dishonour; (ii) the reason assigned for such dishonour; and (iii) the notary's charges.

5.4.2 Protest

'Protest' is a formal certificate of dishonour issued by the notary public to the holder of the bill or note, on his demand (noting is merely a record of dishonour on the instrument itself) (Sec. 100).

Protest for better security: Such protest can be made in the case of bills only. When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may, within a reasonable time, cause a Notary Public to demand better security of the acceptor, and on its being refused, may within a reasonable time cause such facts to be noted and certified as aforesaid. Such certificate is called a protest for better security (Sec. 100, Para 2). It may be noted that in spite of such a protest the holder shall have to wait till the date of maturity to take any action against the acceptor, drawer or indorsers. The only advantage of protest for better security is that it enables the bill to be accepted for honour, for Section 108 provides that when a bill of exchange has been noted or protested for non-acceptance or for better security, the same can thereafter be accepted for honour.

Noting and protest of inland bills or notes is not compulsory, but foreign bills must be protested for dishonour if so required by the law of the place where they are drawn (Sec. 104).

The protest must contain the following particulars (Sec. 101):

1. The instrument itself or a literal transcript of the instrument and of everything written or printed thereupon.
2. The name of the person for whom and against whom the instrument has been protested.
3. The fact and the reasons for dishonour, i.e., a statement that payment or acceptance, or better security, as the case may be, was demanded by the notary public from the person concerned and he refused to give it or did not answer, or that he could not be found.
4. The place and time of dishonour.
5. The signature of the Notary Public.
6. In the case of acceptance for honour or payment for honour, the names of the persons by whom and for whom it is accepted or paid.

5.4.3 Discharge of the Instrument and the Parties

The term 'discharge' in relation to negotiable instruments has two connotations, viz., (i) discharge of the instrument, and (ii) discharge of one or more parties from liability on the instrument.

(i) Discharge of the instrument

A negotiable instrument is said to be discharged when it becomes completely useless, i.e., no action on that will lie, and it cannot be negotiated further. After a negotiable instrument is discharged the rights against all the parties thereto comes to an end, and no party, even a holder in due course, can claim the amount of the instrument from any party thereto.

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Discharge of the party primarily and ultimately liable on the instrument results in the discharge of the instrument itself. For example, in the following cases the instrument is deemed to be discharged:

1. When the party primarily liable on the instrument (i.e., the maker of the note, acceptor of the bill or drawee bank) makes the payment in due course to the holder at or after maturity (Sec. 78). A payment by a party who is secondarily liable does not discharge the instrument because in that case the payer holds it to enforce it against prior indorsers and the principal debtor.
2. When a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, the instrument is discharged (Sec. 90).
3. When the party primarily liable becomes insolvent, the instrument is discharged and the holder cannot make any other prior party liable thereon. Notice that in the case of insolvency, the acceptor or maker is unable to pay and it is only on refusal to pay that the instrument is deemed to be dishonoured and prior parties can be made liable thereon. Similarly, an instrument stands discharged when the primary party liable is discharged by material alteration in the instrument (Sec. 87), or by lapse of time making the debt time barred under the Limitation Act.
4. When the holder cancels the instrument with an intention to release the party primarily liable thereon from the liability, the instrument is discharged and ceases to be negotiable (Sec. 82).

(ii) Discharge of One or More Parties

A party is said to be discharged from his liability when his liability on the instrument comes to an end. When only some of the parties to a negotiable instrument are discharged, the instrument continues to be negotiable and the undischarged parties remain liable on it. Thus, the discharge of one or more parties to an instrument does not discharge the instrument and the rights under it can still be enforced against those parties who continue to be liable thereon.

One or more parties to a negotiable instrument is/are discharged from liability in the following ways:

1. **By cancellation [Sec. 82(a)]:** When the holder of a negotiable instrument deliberately cancels the name of any of the party (by drawing a line through the name) liable on the instrument with an intent to discharge him from liability thereon, such party and all indorsers subsequent to him, who have a right of action against the party whose name is so cancelled, are discharged from liability. Thus, if the maker's

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or acceptor's name has been cancelled the liability of all other parties to the instrument, who must have obviously become parties thereto subsequent to the maker or acceptor and as such must be in the position of sureties to him, comes to an end, which in effect discharges or cancels the instrument itself. But if the name of an indorser has been cancelled, then all the indorsers subsequent to him will be discharged but those prior to him will remain liable. Section 40 contains a similar provision, according to which if the holder, without the consent of the indorser, destroys or impairs the indorser's remedy against a prior party, the indorser is discharged from liability.

It is important to note that where the cancellation is done under a mistake, or without the authority of the holder it would be inoperative and will not discharge any party.

2. **By release [Sec. 82 (b)]:** If the holder of a negotiable instrument releases any party to the instrument by any method other than cancellation of names (i.e., by a separate agreement of waiver, release, or remission), the party so released and all parties subsequent to him, who have a right of action against the party so released, are discharged from liability.
3. **By payment [Sections S2(c) and 78]:** When the party primarily liable on the instrument makes the payment in due course to the holder at or after maturity, all the parties to the instrument stand discharged, because the instrument as such is discharged by such payment.
4. **By allowing drawee more than 48 hours to accept (Sec. 83):** If the holder of a bill of exchange allows the drawee more than forty eight hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.
5. **By taking qualified acceptance (Sec. 86):** If the holder of a bill agrees to a qualified acceptance all prior parties whose consent is not obtained to such an acceptance are discharged from liability.
6. **By not giving notice of dishonour:** Any party to a negotiable instrument (other than the party primarily liable) to whom notice of dishonour is not sent by the holder is discharged from liability as against the holder, unless the circumstances are such that no notice of dishonour is required to be sent.
7. **By non-presentment for acceptance of a bill (Sec. 61):** When a bill of exchange is *payable certain period after sight*, its holder must present it for acceptance to the drawee within a reasonable time after it is drawn. If he makes a default in making such presentment the

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drawer and all indorsers who were liable towards such a holder are discharged from their liability towards him.

8. **By delay in presenting cheque (Sec. 84):** It is the duty of the holder of a cheque to present it for payment within reasonable time of its issue. If he fails to do so and in the meanwhile the bank fails causing damage to the drawer, the drawer is discharged as against the holder to the extent of the actual damage suffered by him.
9. **By material alteration:** Any material alteration of a negotiable instrument renders the same void, i.e., discharges the instrument itself, and all parties thereto at the time of making such alteration and not consenting to the change are discharged from liability thereon (Sec. 87). But persons who become parties to the instrument after the alteration are liable under the instrument as altered. In other words, those who take an altered instrument cannot complain (Sec. 88).

   It is worth noting that the material alteration of the instrument discharges all the parties liable thereon at the time of making such alteration, and it makes no difference whether the alteration is for the benefit or detriment to any party to the instrument or whether it is made by the holder of the instrument or by a stranger while the instrument was in the custody of the holder, because the party in custody of the instrument is bound to preserve it in its integrity (*Davidson vs Cooper*) But alteration made by a stranger without any negligence on the part of the holder does not affect the liability of the parties there to (*Guorochandra vs Krushna Charana*).

   It is not every alteration that necessarily would affect the validity of an instrument or the rights of parties thereto. Only when the alteration is 'material', the validity of the instrument or the rights of parties would come in for question. The Negotiable Instruments Act is silent on the question—what constitutes a material alteration? Courts in India have, therefore, followed the English Common Law and held that *anything which has the effect of altering the legal relations between the parties or the character of the instrument or the sum payable amounts to a material alteration.*

   The following are the examples of material alteration:

   (i) Any alteration of the date, the sum payable, the time of payment and the place of payment

   (ii) Alteration by the addition of a new party to the instrument (*Gardener vs Walsh*).

(iii) Alteration of the rate of interest (*Verco Pvt. Ltd. vs Newandram*).

(iv) Tearing off the material part of the instrument.

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There is no material alteration so as to vitiate the instrument in the following cases, as they do not prejudice the rights and liabilities of the parties thereto:

(i) Alteration made for the purpose of correcting a mistake or a clerical error.

(ii) Alteration made to carry out the common intention of the original parties (Sec. 87).

(iii) Alteration made before the instrument is issued.

(iv) Alteration made with the consent of the parties liable on the instrument.

(v) Conversion of bearer cheque into an order cheque.

(vi) Filling blanks in the case of inchoate or incomplete instruments (Sec. 20). Thus, putting a date on the undated cheque by the payee does not amount to material alteration rendering the instrument void (*Bhaskaran Chandrasekharan vs Radhakrishnan*).

(vii) Conversion of blank indorsement into an indorsement in full (Sec. 49).

(viii) Making qualified acceptance (Sec. 86).

(ix) Crossing of an uncrossed cheque (Sec. 125).

(x) Alteration which is the result of an accident, *e.g.*, mutilation by washing, ravages by white ants or rats, document torn by a child, document burnt in part by the hot end of a cigarette (*Hongkong and Shanghai Banking Corporation vs Lo Lee Shi*).

Sometimes, a negotiable instrument is materially altered but does not appear to have been so altered, for example, a cheque is drawn for ₹500 with space left before the amount in both words and figures and the payee fraudulently alters the amount of ₹3,500 which is not apparent. In such cases, if the person or banker liable to pay makes the payment according to the apparent tenor and otherwise is due course, then he will be discharged from liability and such payment cannot be questioned by reasons of the instrument having been altered [Sec. 89(1)].

Where the cheque is an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image and the truncated cheque shall be a material alteration and it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image [Sec. 89(2). Any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same [Sec. 89(3)].

10. **By 'negotiation back' of a bill:** When a bill of exchange comes back to the acceptor by process of negotiation and he becomes its holder, it is called 'negotiation back'. If a bill of exchange which has been negotiated is, at or after maturity, held by the acceptor in his own right, all rights of action thereon are extinguished (Sec. 90).

Check Your Progress

9. How is a negotiable instrument dishonoured?
10. What do you understand by discharge of instrument?

5.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The term 'negotiable instrument' literally means 'a written document transferable by delivery'. According to Section 13 of the Negotiable Instruments Act, 'a negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer'. 'A negotiable instrument may be made payable to two or more payees jointly, or it may be made payable in the alternative to one of two, or one or some of several payees' [Section 13(2)].
2. The following instruments have been recognized as negotiable instruments by statute or by usage or custom: (i) bills of exchange; (ii) promissory notes; (iii) cheques; (iv) government promissory notes; (v) treasury bills; (vi) dividend warrants; (vii) share warrants; (viii) bearer debentures; (ix) port trust or Improvement Trust debentures; (x) hundis; (xi) railway bonds payable to bearer, etc.
3. There are some instruments called 'documents of title', e.g., (i) bills of lading; (ii) dock warrants; (iii) railway receipts and (iv) wharfinger certificates, which,

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like a negotiable instrument, are capable of being transferred by endorsement and/or delivery, but the transferor of such documents cannot give to the holder any better title to the goods than he himself possesses. Such instruments are termed as 'quasi-negotiable instruments' and the provisions of the Negotiable Instruments Act do not apply to them.

4. The essentials of a 'promissory note' are as follows:
   (i) It must be in writing.
   (ii) It must contain a promise or undertaking to pay.
   (iii) The promise to pay must be unconditional.
   (iv) It must be signed by the maker.
   (v) The maker must be a certain person.
   (vi) The payee must be certain.
   (vii) The sum payable must be certain.
   (viii) The amount payable must be in legal tender money of India.
   (ix) The note must be properly stamped.
5. The essential characteristics of a 'bill of exchange' are as follows:
   (i) It must be in writing.
   (ii) It must contain an order to pay.
   (iii) The order to pay must be unconditional.
   (iv) It must be signed by the drawer.
   (v) The drawer, drawee and payee must be certain.
   (vi) The sum payable must be certain.
   (vii) The bill must contain an order to pay money only.
   (viii) It must comply with the formalities as regards date consideration, stamps, etc.
6. An instrument, which in form is such that it may either be treated as a bill of exchange or as a promissory note, is an 'ambiguous instrument'. In such a case, the holder may either treat it as a bill of exchange or a promissory note, but once he has made his choice, the instrument shall henceforth be treated accordingly.
7. Every maker, drawer, payee or indorsee, and if there are several makers, drawers, payees or indorsees, all of them jointly can negotiate an instrument, provided the negotiability of such instrument has not been restricted or excluded by any express words used in the instrument. But the maker, drawer, payee or indorsee cannot negotiate an instrument, unless he is in lawful possession or is holder thereof (Sec. 51).

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8. The two modes of negotiating or transferring a negotiable instrument are: (*i*) negotiating by mere delivery, and (*ii*) negotiating by indorsement as well as delivery.
9. A negotiable instrument may be dishonoured by: (i) non-acceptance or (ii) non-payment. As presentment for acceptance is required only in case of bills of exchange, it is only the bills of exchange which may be dishonoured by non-acceptance. Of course any type of negotiable instrument—promissory note, bill of exchange or cheque—may be dishonoured by non-payment. There are various aspects of dishonour.
10. A negotiable instrument is said to be discharged when it becomes completely useless, i.e., no action on that will lie, and it cannot be negotiated further. After a negotiable instrument is discharged the rights against all the parties thereto comes to an end, and no party, even a holder in due course, can claim the amount of the instrument from any party thereto. Discharge of the party primarily and ultimately liable on the instrument results in the discharge of the instrument itself.

5.6 SUMMARY

- Negotiable instruments are different from other documents because they are easily negotiable; the transferee can sue in his own name without giving notice to the debtor, a bona fide transferee of a negotiable instrument for value gets the instrument 'free from all defects' and certain presumptions apply to all negotiable instruments.
- Bills of exchange, promissory notes, cheques, government promissory notes, treasury bills, dividend warrants, share warrants, etc., are all examples of negotiable instruments; whereas money orders, postal orders, fixed deposit receipts, share certificates and letters of credit are all examples of non-negotiable instruments.
- Negotiation is a transfer of negotiable instrument so as to constitute the transferee a holder thereof, who should be entitled in his own name to sue on the instrument and recover the amount due thereon. Therefore, mere handing over of a bearer instrument to a servant for safekeeping will not be called 'negotiation'. There must be a transfer with intention to pass title and in the manner prescribed by the Act.
- A cheque, being, a species of a bill of exchange, must satisfy almost all the essentials of a bill, e.g., signed by the drawer, containing an unconditional order to pay a certain sum of money, to the order of a person or the bearer, etc.

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- An instrument payable on demand or at sight (i.e., on presentation in case of a cheque or a promissory note, and on acceptance in case of a bill of exchange) is termed as a 'demand instrument'.
- 'Payment in due course' implies payment: (i) according to the apparent tenor of the instrument at or after maturity (ii) in good faith and without negligence (iii) in money (or by cheque if acceptable to the holder) (iv) to a person who is legally entitled to the instrument and is in possession of the same.
- If a person delivers a negotiable instrument to his servant for safe custody or to his solicitor for filing a suit, the delivery does not amount to negotiation and the servant or the solicitor acquires no title to the instrument.
- 'When the maker or holder of a negotiable instrument signs the same, otherwise than as such maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as negotiable instrument, he is said to indorse the same, and is called the indorser'.
- Notice of dishonour means formal communication of the fact of dishonour. It is given to the party sought to be made liable and, therefore, it serves as a warning to the person to whom the notice is given that he could now be made liable. Such a notice also serves the purpose of enabling the person so notified to protect himself against his prior parties.
- According to Section 94 the notice of dishonour may be oral or written. If it is written it may be sent by post. A notice duly addressed and posted is good even though it may be miscarried.
- 'Noting' is the authentic and official proof of presentment and dishonour of a negotiable instrument. The question of noting does not arise in the case of dishonour of a cheque because in such a case the bank, while refusing payment, returns back the cheque giving reasons in writing for the dishonour of the same, and that itself acts as an authentic evidence of the fact of dishonour. Even in the case of inland bills or notes, noting is not compulsory (Sec. 104).
- 'Protest' is a formal certificate of dishonour issued by the notary public to the holder of the bill or note, on his demand (noting is merely a record of dishonour on the instrument itself) (Sec. 100).
- When a bill of exchange comes back to the acceptor by process of negotiation and he becomes its holder, it is called 'negotiation back'.

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5.7 KEY WORDS

- **Negotiable instrument:** It is a written document transferable by delivery.
- **Promissory note:** It is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument.
- **Bill of exchange:** It is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

5.8 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the various forms which are used in negotiable instruments.
2. Write in a brief about special benefits of bill of exchange.
3. Write in short about conditional indorsement.
4. Write in brief about dishonour by non-payment.
5. Write a brief note on distinction between negotiation and assignment.
6. Write a short note on noting and protest in negotiable instruments.
7. Write in brief about discharge of one or more parties.

Long-Answer Questions

1. Analyse in detail the essentials of a promissory note.
2. Enumerate the distinction between a 'promissory note' and a 'bill'.
3. Discuss the role of miscellaneous instruments.
4. Analyse various privileges that a holder in due course enjoys under the negotiable Act.
5. Discuss the various ways in which one or more parties is/are discharged from liability.

5.9 FURTHER READINGS

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UNIT 6 PARTNERSHIP ACT, 1932

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Structure

6.0 INTRODUCTION

Enacted in India in 1932, Section 4 of the Indian Partnership Act states that a partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. To emphasize the element of contract, Section 5 expressly provides that 'the relation of partnership arises from contract and not from status". The Partnership Act does not mention any thing about the maximum number of persons who can be partners in a partnership firm but Section 11 of the Companies Act, 1956, lays down that a partnership consisting of more than 10 persons for banking business and 20 persons for any other business would be illegal. Although sharing of profits is an evidence of partnership, this is not the conclusive test of partnership. There may be persons sharing the profits of a business but who do not by that reason become partners. Persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm' and the name under which their business is carried on is called the 'firm name' (Sec. 4). A firm is merely a collective name of the individuals composing it. Hence,

unlike a company which is a separate legal entity distinct from its members, a firm cannot possess property or employ servants, neither can it be a debtor nor a creditor.

The partnership should be registered as soon as it is formed with the Registrar of Firms of the area. In the absence of registration, the firm will not be able to enforce its legal remedies against outsiders, and the partners also cannot enforce the conditions laid down in the 'partnership deed' through a court of law. A partnership may be formed by oral or by written agreement or agreement of partnership can be inferred from the conduct of the parties. Partnership is based on mutual contract and, therefore, only those who possess the capacity to contract can be partners in a partnership firm.

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This unit aims at analysing the various aspects of Indian Partnership Act, 1932 and explains essential elements of partnership.

6.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the Indian Partnership Act
- Enumerate the nature of partnership
- Explain the essential elements of a partnership
- Analyse the meaning and features of a firm and a partner
- Enumerate the qualities and limitation of partnership
- Understand the partnership deed
- Explain the various kinds of partnership
- Understand the registration of partnership
- Enumerate the rights and duties of partnership
- Explain the dissolution of partnership.

6.2 NATURE AND FEATURES OF PARTNERSHIP

The law of partnership is contained in the Indian Partnership Act, 1932, which came into force on 1 October 1932, except Section 69 (dealing with the effect of non-registration of firms, which came into force on 1 October 1933). Since partnership comes into existence only by a contract between the parties for the purpose, the provisions of the Indian Contract Act, except when they are inconsistent with the express provisions of the Partnership Act, continue to apply to partnership firms (Sec. 3). Section 4 of the Indian Partnership Act, 1932, defines 'partnership' in the following terms:

'Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all'.

6.2.1 Essential Elements of Partnership

There are five elements which constitute a partnership, namely: (1) there must be a contract; (2) between two or more persons; (3) who agree to carry on a business; (4) with the object of sharing profits; and (5) the business must be carried on by all or any of them acting for all *(i.e.,* there must be mutual agency).

All the above elements must coexist in order to constitute a partnership. If any of these is not present, there cannot be a partnership. We now discuss these elements one by one. These are:

1. **Contract:** Partnership is the result of a contract. It does not arise from status, operation of law or inheritance. Thus at the death of father, who was a partner in a firm, the son can claim share in the partnership property but cannot become a partner unless he enters into a contract for the same with other persons concerned. Similarly, the members of Joint Hindu Family carrying on a family business cannot be called partners because their relation arises not from any contract but from status. To emphasize the element of contract, Section 5 expressly provides that 'the relation of partnership arises from contract and not from status'.

   Thus a 'contract' is the very foundation of partnership. It may, however, be either express or implied. Again, it may be oral or in writing (*Laxmibai vs Roshan Lap*).

2. **Association of two or more persons:** Since partnership is the result of a contract, at least two persons are necessary to constitute a partnership. The Partnership Act does not mention any thing about the maximum number of persons who can be partners in a partnership firm but Section 11 of the Companies Act, 1956, lays down that a partnership consisting of more than 10 persons for banking business and 20 persons for any other business would be illegal. Hence, these should be regarded as the maximum limits to the number of partners in a partnership firm.

   Only persons competent to contract can enter into a contract of partnership. Persons may be natural or artificial. A company may, being an artificial legal person, enter into a contract of partnership, if authorized by its Memorandum of Association to do so. There could even be a partnership between a number of companies (*Steel Bros. & Co Ltd. vs Commissioner of Income-tax*). A partnership firm, since it is not recognized as a legal person having a separate entity from that of partners, cannot enter into contract of partnership with another firm or individuals (*Duli Chand vs Commissioner of Income-tax*). When a firm (under a firm name) enters into a contract of partnership with another firm or individual, in that case, in the eye of law the members of the firms or firm become partners in their individual capacity (*Commissioner of Income-tax vs Jadavji Narsidas & Co*.).

3. **Carrying on of business:** The third essential element of a partnership is that the parties must have agreed *to carry on a business.* The term 'business'

is used in its widest sense and includes every trade, occupation or profession [Sec. 2(A)]. If the purpose is to carry on some charitable work, it will not be a partnership. Similarly, if a number of persons agree to share the income of a certain property or to divide the goods purchased in bulk among themselves, there is no partnership and such persons cannot be called partners because in neither case they are carrying on a business.

4. **Sharing of profits:** This essential element provides that the agreement to carry on business must be with the object of sharing profits among all the partners. Impliedly the partnership must aim to make profits because then only profits may be divided among the partners. Thus, there would be no partnership where the business is carried on with a philanthropic motive and not for making a profit or where only one of the partners is entitled to the whole of the profits of the business. The partners may, however, agree to share profits in any ratio they like. Here two aspects of sharing need to be taken into account: These are:

   i. **Sharing of losses not necessary**: To constitute a partnership it is not essential that the partners should agree to share the losses (*Raghunandan vs Harmasjee*). It is open to one or more partners to agree to bear all the losses of the business. The Act, therefore, does not seek to make agreement to share losses a test of the existence of partnership. Section 13(A), however, provides that the partners are entitled to share equally in the profits earned, and shall contribute equally to the losses sustained by the firm, unless otherwise agreed. Thus scaring of losses may be regarded as consequential upon the sharing of profits and where nothing is said as to the sharing of losses, an agreement to share profits implies an agreement to share losses as well. It must be noted that even though a partner may not share in the losses of the business, yet his liability vis-a-vis outsiders shall be unlimited because there cannot be 'limited partnerships' in our country under the Partnership Act.

   ii. **Sharing of profits not conclusive test:** Although sharing of profits is an evidence of partnership, this is not the conclusive test of partnership. There may be persons sharing the profits of a business but who do not by that reason become partners. In this respect, Explanation II to Section 6 clearly states: 'The receipt by a person of a share of the profits of a business, or of a payment contingent upon the earning of profits or varying with the profits earned by a business, does not of itself make him a partner with the persons carrying on the business; and, in particular, the receipt of such share or payment:

      (a) By a lender of money to persons engaged or about to engage in any business,

      (b) By a servant or agent as remuneration,

      (c) By a widow or child of a deceased partner as annuity, or

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(d) By a previous owner or part-owner of the business as consideration for the sale of the goodwill or share thereof, does not itself make the receiver a partner, with the persons carrying on the business'.

The question whether a person sharing profits of a business is a partner or not depends upon the real relation between the parties, as shown by all relevant facts taken together (Sec.6).

5. **Mutual agency:** The fifth element in the definition of a partnership provides that the business must be carried on by all the partners or any (one or more) of them acting for all, that is, there must be mutual agency. Thus every partner is both an agent and principal for himself and other partners, i.e., he can bind by his acts the other partners and can be bound by the acts of other partners in the ordinary course of business. To test whether a person is a partner or not, it should be seen, among other things, whether or not the element of agency exists, i.e., whether the business is conducted on his behalf. It is on the basis of this test that a widow of a deceased partner or a manager having a share in the profits is not a partner, because business is not carried on, on the widow or the deceased behalf. If she or he does something the firm is not legally bound by that.

6.2.2 Test of Partnership

As it has been clear from the above discussion of various elements of partnership, there is no single test of partnership. For example, in one case there may be sharing of profits but may not be any business; in the other case there may be business but there may not be sharing of profits; in yet another case there may be both business and sharing of profits but the relationship between persons sharing the profits may not be that of principal and agent. And in either case, therefore, there is no partnership. Thus, all the essential elements mentioned before must co-exist in order to constitute a partnership. To emphasize this fact, Section 6 expressly provides that 'in determining whether a group of persons is or is not a firm or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together'. Thus, the existence of partnership has to be determined with reference to the real intention of the parties, which must be gathered from all the facts of the case and the surrounding circumstances.

6.2.3 Partners, Firm and Firm Name

Persons who have entered into partnership with one another are called individually 'partners' and collectively a 'firm' and the name under which their business is carried on is called the 'firm name' (Sec. 4).

A 'firm' is not a separate legal entity distinct from its members. It is merely a collective name of the individuals composing it. Hence, unlike a company which is a separate legal entity distinct from its members, a firm cannot possess property

or employ servants, neither can it be a debtor nor a creditor. It cannot sue or be sued by others. It is only for the sake of convenience that in commercial usage terms like 'firm's property', employee of the firm', 'suit against the firm' and so on are used, but in the eye of law that simply means 'property of the partners', 'employee of the partners' and 'a suit against the partners' of that firm. It is relevant to state that for the purposes of the Income Tax Act, a partnership firm is an entity quite distinct from the partners composing it and is assessable separately.

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The partners are free to choose any name for the firm subject to the following rules:

1. The name must not be too identical or similar to the name of another existing firm doing similar business so as to lead to confusion *(Havana Cigars Factories Ltd. vs Oddenino)*. The reason for this rule being that the reputation or goodwill of a firm may be injured, if a new firm could adopt an allied name.
2. The name must not contain words like Crown, Emperor, Empress, Empire, Imperial, King, Queen, Royal, or words expressing or implying the sanction, approval or patronage of Government except when the State Government signifies its consent to the use of such words as part of the firm name by order in writing [Sec. 58(3)].

Check Your Progress

1. What do you understand by partnership?
2. List the main elements of partnership.

6.3 QUALITIES, ADVANTAGES AND LIMITATIONS OF PARTNERSHIP

In this section, we will discuss the formation and registration of a partnership deed.

6.3.1 Formation of Partnership

We know that a partnership may be formed by oral or by written agreement or agreement of partnership can be inferred from the conduct of the parties. The following basic facts must be borne in mind by the persons desirous of entering into an agreement of partnership:

1. The successful working of a partnership depends upon mutual confidence and utmost good faith among the partners because each partner is an agent of others and binds them to the fullest extent of their fortunes. It is therefore, necessary that the partners of a firm be sleeted with extreme care and caution.
2. All the essential elements of a valid contract must be present. There must be free consent of the parties who must be competent to contract, and the object of the partnership should not be forbidden by law or immoral or opposed to public policy.

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3. The mutual rights and obligations of partners must be discussed in detail and should be put in black and white in the shape of a 'partnership deed', before the partnership is actually started. An oral agreement may be alright till the going is normal but in times of adversity or windfall gains, there may be dispute among the partners, on sharing the losses or profits respectively. In such circumstances, an oral agreement is futile as on its basis it is difficult to prove that such and such conditions were agreed upon. It is, therefore, best to have a written agreement.
4. The partnership should be registered as soon as it is formed with the Registrar of Firms of the area. In the absence of registration, the firm will not be able to enforce its legal remedies against outsiders, and the partners also cannot enforce the conditions laid down in the 'partnership deed' through a court of law.

6.3.2 Partnership Deed

The document in which the respective rights and obligations of the members of a partnership are set forth is called a 'partnership deed'. It should be drafted with care and be signed by all the partners. It must be stamped in accordance with the Indian Stamp Act. Each partner should have a copy of the Deed. The firm should be registered and copy of the Deed should be filed at the time of registration with the Registrar of Firms because in the absence of such registration partners cannot enforce the conditions laid down in the Deed through a court of law. The Deed should cover the following points:

(i) The name of the firm and the names and addresses of partners who compose it.

(ii) Nature of business and the town and place where it will be carried on.

(iii) Date of commencement of partnership.

(iv) The duration of partnership.

(v) The amount of capital to be contributed by each partner and the methods of raising finance in future if so required.

(vi) The ratio of sharing profits and losses.

(vii) Interest on partners' capital, partners' loan, and interest, if any, to be charged on drawings.

(viii) Salaries, commissions, etc., if any, payable to partners.

(ix) The method of preparing accounts and arrangement for audit and safe custody of cash, etc.

(x) Division of task and responsibility, i.e., the duties, powers and obligations of all the partners.

(xi) Rules to be followed in case of retirement, death and admission of a partner.

(xii) Expulsion of partners in case of gross breach of duty or fraud.

(xiii) Section 11(2) clearly provides that the Deed may provide that a partner shall not carry on any business other than that of the firm while he is partner, notwithstanding anything contained in Section 27 of the Indian Contract Act where agreements in restraint of trade are void.

(xiv) The circumstances under which the partnership will stand dissolved.

(xv) Arbitration in case of dispute among the partners.

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The terms laid down in the Deed may be varied by consent of all the partners, and such consent may be expressed or may be implied by a course of dealing [Sec. 11(1)].

6.3.3 Duration of Partnership

From the duration point of view, the partnerships may be classified into the following two categories:

1. **Partnership at will:** Where no provision is made by contract between the partners for the duration of their partnership or for the determination of their partnership, the partnership is 'partnership at will' (Sec. 7). Thus, the essence of a 'partnership at will' is that the partners do not fix any term of partnership and are free to break their relationship at their sweet will. It is a partnership for an indefinite period. Such a partnership may be dissolved by any partner by giving a notice to that effect to all the other partners [Sec. 43(1)]. It may be noted that if this freedom to dissolve the firm at will is curtailed by agreement, say, if the agreement provides that the partnership can be dissolved by mutual consent of all the partners only, it will not constitute a 'partnership at will'.
2. **Particular partnership:** When a partnership is formed for *a particular period or for a specific venture,* e.g., for working a coal mine or producing a film, it is called a 'particular partnership' (Sec. 8). In such a case, the partnership is automatically dissolved at the expiry of the fixed term or on the completion of the venture (Sec. 42). Before such time the partnership would not be dissolved unless all the partners agree to it (Sec. 40). If the partners decide to continue such a partnership even after the expiry of the fixed term or the completion of the specific venture then it becomes a 'partnership at will'.

6.3.4 Kinds of Partners

There may be various types of partners in a partnership firm. These are as follows:

1. **Active or actual partners:** Partners who take an active part in the conduct of the partnership business are called 'actual' or 'ostensible' partners. They are full-fledged partners in the real sense of the term. Such a partner must give public notice of his retirement from the firm in order to free himself from liability for acts after retirement.

2. **Sleeping or dormant partners:** Sometimes, however, there are persons who merely put in their capital (or even without capital they may become partners) and do not take active part in the conduct of the partnership business. They are known as 'sleeping' or 'dormant' partners. They do share profits and losses (usually less than proportionately), have a voice in management, but their relationship with the firm is not disclosed to the general public. They are liable to the third parties for all acts of the firm just like an undisclosed principal. They are, however, not required to give public notice of their retirement from the firm.
3. **Silent partners:** Those who by agreement with other partners have no voice in the management of the partnership business are called 'silent' partners. They share profits and losses, are fully liable for the debts of the firm and may take active part in the conduct of the business.
4. **Partner in profits only:** A partner who has stipulated with other partners that he will be entitled to a certain share of profits, without being liable for the losses, is known as a 'partner in profits only'. As a rule such a partner has no voice in the management of the business. However, his liability vis-a-vis third parties will be unlimited because in India we cannot have 'limited partnership'.
5. **Sub-partner:** When a partner agrees to share his share of profits in a partnership firm with an outsider, such an outsider is called a 'sub-partner'. Such a sub-partner has no rights against the firm nor he/she is liable for the debts of the firm.
6. **Partner by estoppel or holding out (Sec. 28):** If a person represents to the outside world by words spoken or written or by his conduct or by lending his name, that he is a partner in a certain partnership firm, he is then estopped from denying his being a partner, and is liable as a partner in that firm to anyone who has on the faith of such representation granted credit to the firm. Actually such a person is not a partner in that firm—no agreement, no sharing in profits and losses, no say in the management, may not be knowing exact place of business, but as he holds himself out to be a partner; he becomes responsible to outsiders as a partner on the principle of *estoppel or holding out.* It is for this reason that such a person is called as 'partner by estoppel' or 'partner by holding out'. He may also be called as 'quasi-partner' for he is not a partner in the full implications of the term; only in the eyes of outside world he is considered a partner. He may also be known as 'nominal partner'.

It is to be emphasized that in order to entitle a person to bring an action under the doctrine of holding out it must be shown that he acted on the faith of the representation while giving credit to the firm. It does not matter whether the person representing himself, or represented to be a partner, does or does not know that the representation has reached the other person so giving credit. But a person who knows nothing about the representation or who knows but does not believe

it or who knows about it subsequently cannot take advantage of this doctrine and make the supposed partner liable as a partner (*Juggilal Kamalapat vs Shiv Chand Bagree*).

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Illustrations:

(*a*) *P* represents to *R* that he is a partner in the firm of *X, Y* and *Z*, while actually he is not a partner. On the faith of this representation *R* gives credit to the firm. The firm of *X, Y* and *Z* becomes insolvent. *R* can make *P* liable on the basis of holding out and *P* is estopped from denying that he is a partner in the firm.

(*b*) *A, B* and *C* are partners in a firm. *D,* who is generally seen in the company of *A, B* and C, tells *M* that he is also a partner in the firm. *P,* who overhears this talk of *D* to *M* and thinking *D* to be a partner of the firm, gives credit to the firm. *P* can make *D* liable for the credit given to the firm on the basis of holding out because for taking advantage of the doctrine of holding out it is not necessary that the representation must be made directly to the person so giving credit.

(c) *X,* who is not a partner in the firm consisting of *Y* and *Z,* represents to *A* that he is also a partner in the firm. *B,* who does not know of the representation gives credit to the firm of *Y* and *Z. B* cannot make *X* liable for the credit given to the firm on the basis of holding out because he has not actually acted on the faith of the representation while giving credit to the firm.

(*d*) A partnership firm consists of *A, B, C* and *D. D* retires from the firm, but fails to give public notice of his retirement and his name continues to be used on letter heads. *D* is liable as a partner by holding out to creditors who have lent on the faith of his being a partner.

It must be noted that the doctrine of holding out does not extend to make the estate or legal representatives of a deceased partner liable for the acts of the firm done after the death of the partner even though no public notice of partner's death is given and the business is continued in the old firm name [Sec. 28(2)]. The principle of holding out does not apply in the case of insolvent partner also (Sec. 45).

6.3.5 Minor Admitted to the Benefits of Partnership

Partnership is based on mutual contract and, therefore, only those who possess the capacity to contract can be partners in a partnership firm. According to the Indian Contract Act an agreement by a minor is void *ab-initio* as against him but he can derive benefit under it. As such a minor cannot be a full-fledged partner, he can at most be admitted to the benefits of a partnership. Section 30 of the Partnership Act thus provides that though a minor cannot be a partner in a firm, but, with the consent of all the partners for the time being, he may be admitted to the benefits of partnership by an agreement executed through his guardian with the other partners. The following points must be noted in this connection:

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(*i*) A minor can be admitted to the benefits of a partnership with the consent of all the existing partners. Consent only of the majority of partners would not be sufficient.

(*ii*) There must be a partnership in existence before a minor can be admitted to its benefits.

(*iii*) There cannot be a partnership consisting of all minors (*Shriram Didwani vs Gourishanker*).

(*iv*) If a minor is made a full-fledged partner under the terms of a partnership deed, the deed would be invalid not only vis-a-vis the minor but also in regard to other partners. Since a minor cannot enter into any contract of partnership, the deed representing the contract is void *ab-initio* in toto and cannot be enforced even vis-a-vis the remaining adult partners (*Dharam Vir vs Jagan Nath*).

The rights and liabilities of a minor who has been admitted to the benefits of partnership are governed by the following rules:

1. The minor is entitled to receive his agreed share of the property and of the profits of the firm.
2. The minor has the right of inspecting and taking copies of the books of accounts of the firm. He has, however, no such right in respect of books other than accounts, as they may contain secrets which should be restricted to real partners alone.
3. The minor is not personally liable to *third parties* for the debts of the firm, but his liability is limited only up to his share in the partnership assets and profits. If partnership assets fall short in clearing the debts of the firm the separate personal property of the minor cannot be applied for payment of the firm debts. To put it differently, the minor shall be a partner in profits only and shall not share in the losses except when liability to third party has arisen, but then too up to his share in the profits and property of the firm.
4. The minor is not entitled to take part in the conducting of the business as he has no representative capacity to bind the firm.
5. The minor cannot bring about any suit against the partners for an account or payment of his share of the property or profits of the firm except when he severs his connection with the firm.
6. On attaining majority or on knowing that he had been admitted to the benefits of partnership, whichever date be later, the minor must decide within six months whether he would or would not like to become a partner in the firm and give public notice of his decision. If he remains silent and fails to give such a notice, it will be presumed that he has elected to be a partner in the firm.

The burden of proving the fact that the minor had no knowledge of his being a partner until a particular date after the expiry of six months of his attaining majority lies on the person asserting that fact.

7. Where the minor becomes a partner either by his own election or by his failure to give notice within the specified time, he becomes personally liable to the third parties for all the debts and obligations of the firm retrospectively from the date of his admission to the benefits of partnership. Of course, his share in the property and profits of the firm shall be the same to which he was entitled as a minor.
8. Where the minor chooses not to become a partner:
   (*a*) his rights and liabilities continue to be those of a minor up to date of his giving public notice;
   (b) his share is not liable for any acts of the firm done after the date of the public notice;
   (*c*) he is entitled to sue the partners for his share of the property and profits in the firm.
9. If after attaining majority but before choosing to become a partner the minor represents or knowingly permits himself to be represented as a partner in the firm, he will be personally liable to anyone who has on the faith of such representation granted credit to the firm on the ground of 'holding out'.

6.3.6 Registration of Partnerships and its Effects

Prior to the passing of the Indian Partnership Act, 1932, there was no provision for the registration of partnership firms in India. As a result it was difficult for a third person to prove the existence of partnership and make his claim against all the members of the firm. Whenever the question of partners' liability arose, they did not hesitate to deny their membership of the partnership in question. As such there was a demand for compulsory registration, as prevalent in England, so that necessary particulars regarding the constitution of the firm could be made available to those who may be dealing with the firm.

In view of the very large number of small partnership firms working in India, where registration may not produce much public benefit, the present Act has made the registration *optional* entirely at the discretion of partners. Under the Partnership Act, it is *not compulsory* for every partnership firm to get itself registered, but an unregistered firm suffers from a number of disabilities. In practice, therefore, few partnerships would deem it advisable to remain unregistered. Here it is essential to look into the following aspects:

i. **Time of registration:** Registration may take place *at any time* during the continuance of the partnership firm. Where the firm intends to institute a suit in a court of law to enforce rights arising from any contract, registration must be effected before the suit is instituted otherwise the court shall not

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entertain the suit. Registration may also be effected even after a suit has been filed by the firm, but in that case it is necessary to withdraw the suit, get the firm registered and then file a fresh suit. Registration of the firm subsequent to the institution of the suit cannot by itself cure the defect.

ii. **Procedure of registration (Sec. 58):** The procedure of registration is very simple. An application in the prescribed form along with the prescribed fee has to be submitted to the Registrar of Firms of the State in which any place of business of the firm is situated or proposed to be situated. The application or statement must be signed by all the partners, or by their agents especially authorized in this behalf, and must contain the following particulars:

   1. The name of the firm.
   2. The place or principal place of business of the firm.
   3. The names of any other places where the firm carries on business.
   4. The date when each partner joined the firm.
   5. The names in full and permanent addresses of the partners.
   6. The duration of the firm.

   When the Registrar is satisfied that the above provisions have been duly complied with, he shall record an entry of the statement in a register called the Register of Firms, and shall file the statement (Sec. 59). This completes the procedure of registration.

iii. **Change of particulars**: With a view to keep the Registrar of Firms posted with up-to-date information regarding the firm, if any change takes place in any of the particulars given above, it should be notified to the Registrar, who shall thereupon incorporate the necessary change in the Register of Firms. Further, the Registrar should also be informed when any partner ceases to be a partner by retirement, expulsion, insolvency or death, or when a new partner is admitted or a minor, having been admitted, elects to become or not to become a partner, or when the firm is dissolved. (Sections 60–63).

iv. **Penalty for false particulars**: If any person knowingly or without belief in its truth signs any statement, amending statement, notice or intimation containing false or incomplete information to be supplied to the Registrar, he shall be punishable with imprisonment which may extend to three months, or with fine, or with both. (Sec. 70).

v. **Effects of non-registration (Sec. 69):** An unregistered firm and its partners suffer from the following disabilities:

   1. No suit in a civil court by a partner against the firm or other co-partners: If any dispute arises among the partners or between a partner and the firm or between a partner and ex-partners, and the dispute is based upon the rights arising from contract (i.e., partnership deed) or upon the rights conferred by the Partnership Act, then a partner of an

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unregistered firm cannot institute a suit to settle such disputes. However, criminal proceedings can be brought by one partner against the other(s). Thus, if a partner steals the property of the firm or sets fire to the buildings of the firm, any partner can prosecute him for the same.

2. No suit in a civil court by firm against third parties: An unregistered firm cannot file a suit against a third party, if it so becomes necessary, to enforce any right arising from contract, e.g., for the recovery of the price of goods supplied. Of course, criminal proceedings can be brought against the wrong doers. It may be noted that a suit by a third party against the firm or its partners is not prohibited, it is only a suit by the firm, and that too arising out of a contract, against a third party which is prohibited.
3. The firm or its partners cannot make a claim of set-off or other proceeding based upon a contract. The above two disabilities also apply to a claim of *set-off* or *other proceeding* to enforce a right arising from a contract. Thus, if a third party sues the firm to recover a sum of money, the firm cannot claim a set-off, i.e., the firm cannot say that the third party also owes some money to the firm and the same should be adjusted against the claim in question. Similarly, if an unregistered firm institutes a suit for the reduction of rent against its landlord, such a suit is not maintainable because the suit falls under the disability relating to 'other proceeding' to enforce a right arising from a contract (*Gappulal Gordhandas vs Chunilal Shyamla*).

However, there are a few exceptions**.** Non-registration of a firm does not, however, affect the following rights, namely:

1. The right of third parties to sue the firm or any partner.
2. The right of partners to sue for the dissolution of the firm or for the accounts of a dissolved firm or for the realisation of the property of a dissolved firm (i.e., for claiming share of the assets of a dissolved firm or for recovering money from firm's debtors).
3. The power of an Official Assignee or Receiver or the Court, as the case may be, to realise the property of an insolvent partner and to bring an action therefore, if necessary, on behalf of the insolvent.
4. The rights of firm or partners of firm having no place of business in India.
5. The right to sue or claim a set-off if the value of suit does not exceed ₹ 100 in value.

It may be mentioned that registration of firms from income-tax point of view is different from the registration of firms discussed above. For the purpose of assessment of income-tax separate registration with the income-tax department is needed. However, this is also optional.

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6.3.7 Register of Firms

The Register of Firms maintained at the Registrar of Firms' office contains complete and up-to-date information about each registered firm regarding all matters likely to affect the interests of those persons who propose to deal with the firm. The Registrar is empowered to rectify any mistake in the Register of Firms (Sec. 64). The Registrar is bound to amend the entry in the Register, if so directed by the Court as a consequence of its decision relating to a matter concerning the registered firm (Sec. 65). The Register of Firms shall be open to inspection by any person on payment of the prescribed fee (Sec. 66). The Registrar is bound to supply on demand, on payment of the prescribed fee, a copy of any entry in the Register of Firms (Sec. 67). The Register of Firms is a *conclusive proof* of the truth of the matters contained therein as against the parties signing the statements on the basis of which the Register is prepared. The third party, however, is allowed to challenge the fact of a statement and prove that it is false (Sec. 68). As such if a person's name does not appear in the Register of Firms as a partner, the third party may prove that he is a partner in the firm.

6.3.8 Property of the Firm

Section 14 provides that subject to contract between the partners, the property of the firm includes all property and rights and interest in property originally brought into the stocks of the firm, or acquired by purchase or otherwise, by or for the firm, or for the purpose and in the course of the business of the firm, and includes also the goodwill of the business. If a partner brings in immovable property as his share of capital in the firm, that becomes the property of the firm even without a formal document of transfer in the name of the partnership firm. Similarly, property purchased with the partnership money is deemed to be the property of the firm even if a partner purchases that in his own name, unless a contrary intention appears from the conduct of the partner concerned.

Illustrations:

(*a*) *A* and *B* are partners. *A* buys railway shares in his own name with the moneys and on account of the firm. The shares are partnership property.

(*b*) *A* and *B* are partners. *A* buys land with partnership moneys, for his sole benefit. Thereafter *A* debits himself in the firm books' and becomes a debtor to the firm for the amount of the purchase money. The land is not partnership property, because there was clearly a contrary intention (*Smith vs Smith*).

Check Your Progress

3. How is a partnership formed?
4. What is a partnership deed?
5. List the kinds of partner.
6. How can a minor be a part of partnership?
7. What is the procedure of the registration of partnership firms in India?

6.4 RIGHTS AND DUTIES OF PARTNERS

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'Subject to the provisions of this Act, the mutual rights and duties of the partners of a firm may be determined by contract between the partners, and such contract may be express or may be implied by a course of dealing. Such contract may be varied by consent of all the partners, and such consent may be express or may be implied by a course of dealing' [Sec. 11(1)]. Thus, except in cases where the Partnership Act makes a mandatory provision, the partners are entitled to agree to the terms and provide for their mutual rights and duties.

6.4.1 Rights of Partners

Subject to contract between the partners, the Partnership Act confers the following rights upon the partners of a firm:

1. **Right to take part in the conduct of the business [Sec. 12 (*a*)]:** Every partner, irrespective of the amount of capital contribution, has an inherent right to take part in the conduct of the business of the firm. Although one may agree not to participate in the management of the business, the right of participation should be available to each partner.
2. **Right to be consulted [Sec. 12 (*c*)]:** Every partner has a right to be consulted and heard before any matter is decided. Any difference arising as to ordinary matters connected with the business may be decided by a majority of the partners. But no change may be made in the nature of the business or the constitution of the partnership, *e.g.;* admission of a new partner, without the consent of all the partners. The partnership deed may, however, provide that in all matters consent of all the partners is necessary or that all matters shall be decided by majority opinion. It may be noted that majority powers should be exercised in good faith for the benefit of the firm. If the majority of the partners decide to expel a partner without sufficient cause, the expulsion would be set aside.
3. **Right of access to books [Sec. 12(*d*)]:** Every partner has a right to have access to and to inspect and copy any of the books of the firm.
4. **Right to share the profits [Sec. 13 (*b*)]:** Every partner, irrespective of the amount of capital contribution or business expertise, has a right to share equally in the profits earned by the firm.
5. **Right to interest on capital [Sec. 13 (*c*)]:** Where a partner is entitled to interest on capital subscribed by him, such interest shall be payable only out of profits.
6. **Right to interest on advances [Sec. 13(*d*)]:** Where a partner makes, for the purpose of the business, any payment or advance beyond the amount of capital he has agreed to subscribe, he is entitled to interest thereon at the rate of 6 per cent per annum.

7. **Right to indemnity [Sec. 13 (*e*)]*:*** Every partner has a right to claim indemnity from the firm in respect of payments made or liabilities incurred by him:

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   (*a*) in the ordinary and proper conduct of the business, and
   (*b*) in doing such act, in an emergency, for the purpose of protecting the firm from loss, as would be done by a person of ordinary prudence, in his own case, under similar circumstances.

6.4.2 Duties of Partners

For the sake of clarity, we shall be studying the duties of partners *inter se* under the following two heads:

1. Absolute duties.
2. Qualified duties.

1. **Absolute duties:** These duties are imposed by law and are not subject to a contract to the contrary. Being mandatory in nature, these duties are applicable to all partnership and cannot be varied by agreement among the partners. The following are the absolute duties of partners:
   i. **Duty to carry on the business to the greatest common advantage (Sec. 9):** Every partner is bound to carry on the business of the firm to the greatest common advantage. It implies that every partner must use his knowledge and skill for the benefit of the firm and not for his personal gain. He must conduct the business with the best of his ability and secure maximum benefits for the firm.
   ii. **Duty to be just and faithful inter-se (Sec. 9):** An ideal partnership is one where there is mutual trust and confidence, and spirit of helpfulness and goodwill among the partners. As such every partner must be just and faithful to his co-partners. He must observe utmost good faith and fairness towards other partners of the firm.
   iii. **Duty to render true accounts (Sec. 9):** Every partner must render true and proper accounts to his co-partners. It implies that each partner must be ready to explain the accounts of the firm and produce vouchers in support of the entries. No partner should think of making a secret profit at the expense of the firm.
   iv. **Duty to provide full information (Sec. 9):** Every partner must give full information of all things affecting the firm to his co-partners. A partner, being an agent of other partners, must not conceal any information concerning the firm from the other partners by reason of the law of agency as well. Law of agency provides that knowledge to the agent is deemed to be knowledge to the principal.
   v.. **Duty to indemnify for loss caused by fraud (Sec. 10):** A partner can cause loss to the firm by his neglect or want of skill or omission or fraud while acting in the ordinary course of business. The general

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practice is that when the loss caused by neglect or want of skill or omission, it is borne by the firm. But when the loss is caused by fraud committed against a third party by a partner, the same must be recovered from the guilty partner and cannot be shared among all the partners. Section 10 gives statutory recognition to this rule and provides that 'every partner must indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm'. The object of this provision is to discourage partners to deal fraudulently in the conduct of the business.

vi. **Duty to be liable jointly and severally (Sec. 25):** Every partner is liable, jointly with all the other partners and also severally, to third parties for all acts of the firm done while he is a partner. The liability of all the partners is not only joint and several but is also unlimited. Thus if a firm fails to pay a creditor, he may at his discretion bring an action against some or all the partners for the whole amount.

vii. **Duty not to assign his interest (Sec. 29):** No partner can assign or transfer his partnership interest to any other person so as to make him a partner in the business without the consent of all other partners. He can, however, assign his share of the profit and his share in the assets of the firm but the transferee shall not have any right to interfere in the conduct of the business.

2. **Qualified duties:** Qualified duties are those which depend upon the contract between the partners and it is only in the absence of a contract to the contrary that these duties, as laid down by the Indian Partnership Act, are applicable. In other words, the partners are free to vary these duties by mutual agreement, express or implied, and if the partnership agreement is silent then only the duties contained in the Indian Partnership Act will be the duties of the partners. Subject to contract between the partners, the Partnership Act prescribes the following duties of partners *inter-se:*

    1. **Duty to attend diligently to his duties [Sec. 12(b)]:** Every partner is bound to attend diligently to his duties in the conduct of the business.
    2. **Duty to work without remuneration [Sec. 13(a)]:** A partner is not entitled to receive remuneration for taking part in the conduct of the business:
    3. **Duty to contribute to the losses [Sec. 13(b)]:** The partners are bound to contribute equally to the losses sustained by the firm, irrespective of the amount of capital contribution by each one of them.
    4. **Duty to indemnify for wilful neglect [Sec. 13]:** Every partner is under a duty to indemnify the firm for any loss caused to it by his wilful neglect in the conduct of the business of the firm. The expression 'wilful neglect' means the failure to perform a duty, or to do something which a partner ought to have done, intentionally and deliberately. An act

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done in good faith and *bona fide* or a mere error of judgment cannot be termed as wilful neglect.

5. **Duty to use firm's property exclusively for the firm [Sec. 15]:** It is the duty of every partner to use the property of the firm exclusively for the purposes of the business. No partner should use partnership property for his personal benefit.
6. **Duty to account for personal profits derived [Sec. 16(a)]:** If a partner derives any profit for himself from any transaction of the firm or from the use of the property or business connection of the firm or the firm name, he must account for that profit and pay it back to the firm.
7. **Duty not to compete with the business of the firm [Sec. 16(b)]:** A partner must not carry on any business which is similar to or likely to compete with the business of the firm. If he does that, he is bound to account for and pay to the firm all profits made by him in that business. A partner may, however, carry on a non-competing business and may retain the profits of that business to himself.

6.5 DISSOLUTION OF A PARTNERSHIP FIRM

The Indian Partnership Act distinguishes between:

(*a*) Dissolution of firm, and

(*b*) Dissolution of partnership.

Section 39 provides that the dissolution of partnership between all the partners of a firm is called the 'dissolution of the firm'.

When one or more partners cease to be partners of the firm but others continue the business in partnership, it is called 'dissolution of partnership'. In this case, the firm is reconstituted without any dissolution.

It follows that the dissolution of the firm necessarily involves the dissolution of partnership as well, but the dissolution of the partnership may or may not involve the dissolution of the firm. For example, where *A, B* and *C* were partners in a firm and *A* died, retired or adjudged insolvent, the 'partnership firm' as well as the 'partnership' would come to an end in the absence of a contract to the contrary. But if the partners have agreed that the death, retirement or insolvency of a partner would not dissolve the firm, then on the happening of any of these events, 'partnership' would certainly come to an end, although the 'firm' may continue under the same firm name.

6.5.1 Dissolution of Firm

A firm may be dissolved in any one of the following ways:

1. **By agreement (Sec. 40):** A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners. Partnership is created by contract, it can also be terminated by contract.

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2. **By notice (Sec. 43):** Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. A notice of dissolution once given cannot be withdrawn without the consent of other partners (*Jones vs Lloyd*). The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice.
3. **On the happening of certain contingencies (Sec. 42):** Subject to contract between the partners, a firm is dissolved:
   (*a*) if constituted for a fixed term, by the expiry of that term;
   (*b*) if constituted to carry out one or more adventures or undertakings, by the completion thereof;
   (*c*) by the death of a partner; and
   (*d*) by the adjudication of a partner as an insolvent.

   The partnership agreement may provide that the firm will not be dissolved in any of the aforementioned circumstances. Such a provision is valid.
4. **Compulsory dissolution (Sec. 41):** A firm is compulsorily dissolved under any of the following circumstances:
   (*a*) When all the partners, or all the partners but one, are adjudged insolvent;
   or
   (*b*) When some event has happened which makes it unlawful for the business of the firm to be carried on *or* for the partners to carry it on in partnership (e.g., when any partner, who is a citizen of a foreign country, becomes an alien enemy because of the declaration of war between his country and India). Where, however, a firm is carrying on more than one adventures or undertakings, the illegality of one or more shall not of itself cause the dissolution of the firm in respect of its lawful adventures or undertakings.
5. **Dissolution by the Court (Sec. 44):** Dissolution of a firm by the Court is necessitated when there is a difference of opinion between the partners regarding the matter of dissolution. For example, where one of the partners has become insane, some of the partners may be willing to continue the firm and share profits with the insane partner, while the other partners) may be insisting on the dissolution of the firm. Obviously in these circumstances, intervention by the Court becomes necessary. On receiving the petition for the dissolution of the firm the Court is not bound to decree dissolution and it enjoys complete discretion in the matter. It may or may not order for the dissolution of the firm depending upon the merits of each case.

   Section 44 enumerates the various grounds on which a petition may be made to the court for the dissolution of the firm. The Section lays down that

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at the suit of a partner, the Court *may* dissolve a firm on any of the following grounds:

(*a*) *Insanity:* When a partner becomes insane. In this case the Section permits not only any of the partners but also the next friend of the insane partner to file the suit for dissolution of the firm.

(*b*) *Permanent incapacity:* When a partner, other than the partner suing, becomes permanently incapable of performing his duties as partner.

(*c*) *Misconduct:* When a partner, other than the partner suing, is guilty of misconduct, which is likely to affect prejudicially the carrying on of the business of the firm. It is not necessary that the misconduct which is made the ground of dissolution should be connected with partnership business. Conviction for travelling without ticket or the adultery by one partner with another partner's wife are good grounds for the dissolution of the firm. Under this clause, the suit cannot be brought by the guilty partner for that would allow him an excuse for getting a firm dissolved at his will.

(*d*) *Persistent breach of agreement:* When a partner, other than the partner suing, commits frequent breaches of the partnership agreement or otherwise so conducts himself in matters relating to the business that other partners find it impossible to carry on the business in partnership with him. Taking away the books of accounts, using firm's monies for his private debts, continuous quarrelling with other partners are good grounds for the dissolution.

(*e*) *Transfer of interest:* When a partner, other than the partner suing, has transferred the whole of his interest in the firm to a third party or has allowed his share to be sold in execution of a decree. Transfer or assignment of partner's interest does not by itself dissolve the firm. But the other partners may apply to the Court to dissolve the firm if such a transfer occurs.

(*f*) *Continuous losses:* When the business of the firm cannot be carried on except at a loss.

(*g*) *Just and equitable:* When on any other ground the Court considers it just and equitable that the firm should be dissolved, for example, if partners are not on speaking terms.

Check Your Progress

8. List the types of duties of partners.
9. What do you mean by dissolution of partnership?

6.6 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

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1. Section 4 of the Indian Partnership Act, 1932, defines 'partnership' in the following terms: 'Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all'.
2. There are five elements which constitute a partnership, namely: (i) there must be a contract; (ii) between two or more persons; (iii) who agree to carry on a business; (iv) with the object of sharing profits; and (v) the business must be carried on by all or any of them acting for all (i.e., there must be mutual agency).
3. A partnership may be formed by oral or by written agreement or agreement of partnership can be inferred from the conduct of the parties. However, there are some basic facts which must be borne in mind by the persons desirous of entering into an agreement of partnership.
4. The document in which the respective rights and obligations of the members of a partnership are set forth is called a 'partnership deed'. It should be drafted with care and be signed by all the partners. It must be stamped in accordance with the Indian Stamp Act. Each partner should have a copy of the Deed.
5. There may be various types of partners in a partnership firm. These are as follows:
   - i. Active or actual partners: Partners who take an active part in the conduct of the partnership business are called 'actual' or 'ostensible' partners. They are full-fledged partners in the real sense of the term.
   - ii. Sleeping or dormant partners: Sometimes, however, there are persons who merely put in their capital (or even without capital they may become partners) and do not take active part in the conduct of the partnership business. They are known as 'sleeping' or 'dormant' partners.
   - iii. Silent partners: Those who by agreement with other partners have no voice in the management of the partnership business are called 'silent' partners.
   - iv. Partner in profits only: A partner who has stipulated with other partners that he will be entitled to a certain share of profits, without being liable for the losses, is known as a 'partner in profits only'.
   - v . Sub-partner: When a partner agrees to share his share of profits in a partnership firm with an outsider, such an outsider is called a 'sub-partner'.
   - vi. Partner by estoppel or holding out (Sec. 28): If a person represents to the outside world by words spoken or written or by his conduct or by

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lending his name, that he is a partner in a certain partnership firm, he is then estopped from denying his being a partner, and is liable as a partner in that firm to anyone who has on the faith of such representation granted credit to the firm.

6. As such a minor cannot be a full-fledged partner, he can at most be admitted to the benefits of a partnership. Section 30 of the Partnership Act thus provides that though a minor cannot be a partner in a firm, but, with the consent of all the partners for the time being, he may be admitted to the benefits of partnership by an agreement executed through his guardian with the other partners.
7. The procedure of registration is very simple. An application in the prescribed form along with the prescribed fee has to be submitted to the Registrar of Firms of the State in which any place of business of the firm is situated or proposed to be situated. The application or statement must be signed by all the partners, or by their agents especially authorized in this behalf, and must contain the following particulars:
   i. The name of the firm.
   ii. The place or principal place of business of the firm.
   iii . The names of any other places where the firm carries on business.
   iv. The date when each partner joined the firm.
   v. The names in full and permanent addresses of the partners.
   vi. The duration of the firm.
8. There are two types of duties of partners. These are:
   i Absolute duties:These duties are imposed by law and are not subject to a contract to the contrary. Being mandatory in nature, these duties are applicable to all partnership and cannot be varied by agreement among the partners.
   ii. Qualified duties: Qualified duties are those which depend upon the contract between the partners and it is only in the absence of a contract to the contrary that these duties, as laid down by the Indian Partnership Act, are applicable. In other words, the partners are free to vary these duties by mutual agreement, express or implied, and if the partnership agreement is silent then only the duties contained in the Indian Partnership Act will be the duties of the partners.
9. When one or more partners cease to be partners of the firm but others continue the business in partnership, it is called 'dissolution of partnership'.

6.7 SUMMARY

- Section 4 of the Indian Partnership Act, 1932, defines 'partnership' in the following terms: 'Partnership is the relation between persons who have

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agreed to share the profits of a business carried on by all or any of them acting for all'.

- There are five elements which constitute a partnership, namely: (1) there must be a contract; (2) between two or more persons; (3) who agree to carry on a business; (4) with the object of sharing profits; and (5) the business must be carried on by all or any of them acting for all (i.e., there must be mutual agency).
- The successful working of a partnership depends upon mutual confidence and utmost good faith among the partners because each partner is an agent of others and binds them to the fullest extent of their fortunes. It is therefore, necessary that the partners of a firm be sleeted with extreme care and caution.
- The document in which the respective rights and obligations of the members of a partnership are set forth is called a 'partnership deed'. It should be drafted with care and be signed by all the partners. It must be stamped in accordance with the Indian Stamp Act. Each partner should have a copy of the Deed.
- When a partner agrees to share his share of profits in a partnership firm with an outsider, such an outsider is called a 'sub-partner'. Such a sub-partner has no rights against the firm nor is he/she liable for the debts of the firm.
- The minor cannot bring about any suit against the partners for an account or payment of his share of the property or profits of the firm except when he severs his connection with the firm.
- The procedure of registration is very simple. An application in the prescribed form along with the prescribed fee has to be submitted to the Registrar of Firms of the State in which any place of business of the firm is situated or proposed to be situated.
- 'Subject to the provisions of this Act, the mutual rights and duties of the partners of a firm may be determined by contract between the partners, and such contract may be express or may be implied by a course of dealing. Such contract may be varied by consent of all the partners, and such consent may be express or may be implied by a course of dealing' [Sec. 11(1)].
- When a partner is expressly authorized by an agreement of all the partners to do certain acts on behalf of the firm, it is called 'express authority of a partner'. The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.
- Mutual confidence and trust among the partners being an essential ingredient of an ideal partnership, it is very much natural that there must be a consent of all the partners to the introduction of a new partner, unless the partners have already agreed otherwise.

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- A retiring partner also continues to be liable for the acts of the firm, even after retirement, until public notice is given of the fact of retirement. Similarly, the partners of the reconstituted firm continue to be liable for the acts of the retired partner though done after retirement, until public notice is given of the retirement.
- Where a partner in a firm is adjudicated as insolvent, he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is thereby dissolved will depend upon the agreement of partnership between the partners.
- A continuing guarantee given to a firm, or to a third party in respect of the transactions of a firm, is, in the absence of agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm.
- When one or more partners cease to be partners of the firm but others continue the business in partnership, it is called 'dissolution of partnership'. In this case, the firm is reconstituted without any dissolution.
- Dissolution of a firm by the Court is necessitated when there is a difference of opinion between the partners regarding the matter of dissolution. For example, where one of the partners has become insane, some of the partners may be willing to continue the firm and share profits with the insane partner, while the other partners) may be insisting on the dissolution of the firm.

6.8 KEY WORDS

- **The Registrar of Firms**: It is a process of Registration is done with the Registrar of Firms (ROF), ROF is the body which regulates the registration of Partnership Firm. ROF also check the functions of the Registered Partnership Firms.
- **Retiring partner**: A partner, who goes out of a firm, is called retiring partner or outgoing partner.
- **Insolvency**: This is the state of being unable to pay the money owed, by a person or company, on time; those in a state of insolvency are said to be insolvent.

6.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the Indian Partnership Act, 1932.
2. Write in a brief about the role of 'contract' in partnership.

3. Write a short note on the registration of a partnership deed.
4. Write in brief about liability of an incoming partner.
5. Write a brief note on dissolution of partnership.

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Long-Answer Questions

1. Analyse the concept and nature of a partnership firm in India.
2. Discuss the various points that Partnership Deed should cover.
3. Analyse the effects of non-registration in partnership.
4. "If a minor is made a full-fledged partner, the deed would be invalid." Justify this statement with relevant illustrations.
5. Discuss the continuing liability of partners after dissolution as stated in Section 45.

6.10 FURTHER READINGS

Kuchhal, M.C. and Vivek Kuchhal. 2013. *Business Law,* sixth edition. Delhi: Vikas Publishing House.

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UNIT 7 COMPANIES ACT, 1956

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Structure

7.0 INTRODUCTION

The Companies Act, 1956, constitutes the Company Law in India. It contains elaborate provisions relating to the formation, powers and responsibilities of the directors and managers, raising of capital, holding of company meetings, maintenance and audit of company accounts, powers of inspection and investigation of company affairs, and winding up of companies. The Act contains 658 Sections and XV Schedules. The Central Government exercise control over the Registrars of Companies through the respective Regional Directors who happen to be senior officers of the Company Law Board. A company may be incorporated either by a special Act of legislature or under the Companies Act and accordingly a company may be: (i) statutory company, or (ii) incorporated company.

A company is brought into existence by a legal process called incorporation. This is effected by registration with the Registrar of Companies. The memorandum of association of a company is its principal document. 'It is a document of great importance in relation to the proposed company'. No company can be registered without a memorandum of association and that is why it is sometimes called a life giving document.

In this unit, we shall study the meaning and nature of a company, the Act constituting the Company Law in India and its administration has also been discussed in detail.

7.1 OBJECTIVES

After going through this unit, you will be able to:

- Learn the meaning and essential characteristics of a company
- Analyse the various types of companies
- Understand the Company Law in India
- Enumerate the meaning and concept of incorporation
- Analyse the role of meeting and voting

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7.2 COMPANY: MEANING AND DEFINITIONS

Section 3(l)(i) and (ii) of the Companies Act, 1956, define a company as 'a company formed and registered under this Act or an existing company. An 'existing company' means a company formed and registered under any of the former Companies Acts'.

This definition does not reveal the distinctive characteristics of a company. Perhaps, the clearest description of a company is given by Lord Justice Lindley:

> By a company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it, or to whom, it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted.

A more comprehensive legal definition of a company giving its *essentials*, has been given by L.H. Haney: 'A company is an incorporated association, which is an artificial person created by law, having a separate entity, with a perpetual succession and a common seal.'

A company, thus, may be defined as an incorporated association, which is an artificial legal person, having a separate legal entity, with a perpetual succession, a common seal, a common capital comprising transferable shares and carrying limited liability.

7.2.1 Characteristics of Company

An examination of the definitions reveals the following essential characteristics of a company:

(i) **Incorporated association:** A company must necessarily be incorporated or registered under the prevalent Companies Act. Registration creates a joint stock company and it is compulsory for all associations or partnerships, having a membership of more than 10 in banking and more than 20 in any other trading activity, formed for carrying on a business with the object of earning profits.

(ii) Artificial legal person: A company is an artificial legal person in the sense that on the one hand, it is created by a process other than natural birth and does not possess the physical attributes of a natural person, and on the other hand, it is clothed with many of the rights of a natural person. It is invisible, immortal (law alone can dissolve it) and exists only in the eyes of law. It has no body, no soul, no conscience, neither is it subject to the imbecilities of the body. It is because of these physical disabilities that a company is called an *artificial person.* However, it cannot be treated as a *fictitious* entity because it really exists. As a rule, a company may acquire and dispose of property; it may enter into contracts through the agency of natural persons and it may be fined for the contravention of the provisions of the Companies Act. Thus, for most legal purposes, a company is a *legal person* just like a natural person, who has rights and duties at law. In short, it may be said, therefore, that a company being an artificial legal person can do everything like a natural person, except of course that, it cannot take oath, cannot appear in its own person in the court (must be represented by counsel), cannot be sent to jail, cannot practice a learned profession like law or medicine, nor can it marry or divorce.

(iii) Separate legal entity: A company is a legal person having a juristic personality entirely distinct from and independent of the individual persons who are for the time being its members (*Kathiawar Industries Ltd vs C.G. of Evacuee Property*). It has the right to own and transfer the title to property in any way it likes. No member can either individually or jointly claim any ownership rights in the assets of the company during its existence or in its winding up (*Mrs B.F. Gazdar vs the Commissioner of Income Tax*). It can sue and be sued in its own name by its members as well as outsiders. Creditors of the company are creditors of the company alone and they cannot directly proceed against the members personally.

A company is not merely the sum total of its component members, but it is something superadded to them. In mathematical language, it may be defined as *n + 1th person*, where *n* stands for the total number of members and the *1th* person for the company itself. Even if a shareholder owns virtually the whole of its shares, the company is a separate legal entity in the eyes of law as distinguished from such a shareholder. This principle was judicially recognized by the House of Lords in the famous case of *Salomon vs Salomon & Co. Ltd.*

Lord Macnaghten observed in this case:

The company is at law a different person altogether from the subscribers to the Memorandum; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers, as members liable, in any shape or form, except to the extent and in the manner provided by the Act.

It is not a citizen. Although a company is a legal person having nationality in accordance with the country of its incorporation and a domicile in accordance with the place or state of its incorporation or registration, *it is not a citizen (State Trading Corporation of India Ltd vs Commercial Tax Officer*).

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(iv) Perpetual existence: A company is a stable form of business organization. Its life does not depend upon death, insolvency or retirement of any or all shareholder(s) or director(s). The provision for transferability of shares in case any shareholder wishes to drop out, as also for transmission of shares to the successor(s) of the deceased in case any shareholder dies, helps to preserve the perpetual existence of a company. Law creates it and law alone can dissolve it. Members may come and go, but the company can go on forever. The company may be compared with a flowing river where water keeps changing continuously, still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership.

(v) Common seal: A company being an artificial person has no body similar to natural person and as such it cannot sign documents for itself. It acts through natural persons who are termed as *directors*. However, having a legal personality, it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of a *common seal*, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company.

(vi) Limited liability: The liability of the members for the debts of the company is limited to the amount unpaid on their shares howsoever heavy losses the company might have suffered. For instance, if a shareholder buys 100 shares of ₹10 each and pays ₹5 on each share, he has paid ₹500 and can be made no pay another ₹500, but he cannot be made to pay more than ₹ 1,000 in all. No shareholder can be called upon to pay more than the nominal or face value of shares held by him, in case of a company with limited liability. Thus, by virtue of this characteristic the personal property of the shareholder cannot be seized for the debts of the company, if he holds a fully paid-up share.

(vii) Transferability of shares: The shares of a public company are freely transferable and members can dispose of their shares whenever they like without seeking any permission from the company or the other members. In a *private company*, however, some restriction on the right to transfer is *essential* in its articles as per Section 3(l)(iii) of the Act, but absolute restriction on the right of the members to transfer shares contained in the articles shall be void.

It may, however, be noted here that a company possesses all these characteristics by virtue of its *incorporation* or registration under the Companies Act. Although a partnership—the main alternative to the company as a form of business organization—may also be registered under the Indian Partnership Act, 1932, yet it does not possess any of these characteristics.

7.2.2 Classification of Companies

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A company may be incorporated either by a special Act of legislature or under the Companies Act and accordingly, a company may be:

(i) Statutory company, or

(ii) Incorporated company.

(i) Statutory company: It is incorporated by a special Act passed either by the Central legislature or state legislature. Companies intending to carry on some business of national importance are formed in this way. Examples of such companies include: Reserve Bank of India, State Bank of India, Life Insurance Corporation, Food Corporation of India, Unit Trust of India, etc. The powers which are to be exercised by such companies are defined by the Acts constituting them and therefore, they are not required to have a memorandum of association (a document which defines the limitation of the powers of a company), as also to use the word 'Limited' as part of their names. The audit of such companies is conducted under the supervision and control of the Auditor General of India. Although each statutory company is governed by the provisions of its special Act, the provisions of the Companies Act, 1956, also apply to them, in so far as the said provisions are not inconsistent with the provisions of the special Acts under which these companies are formed (Sec. 616).

(ii) Incorporated or registered company: A company registered under the Companies Act is known as 'incorporated' or 'registered' company. All existing companies in India, except the statutory companies, have been formed in this way and are governed by the provisions of the Companies Act, 1956. It may, however, be noted that insurance, banking and electric supply companies though incorporated under the Companies Act are also governed for most of their operative matters by provisions of their special Acts, viz., the Insurance Act, 1938, the Banking Regulation Act, 1949, and the Electricity Supply Act, 1948, and the provisions of the Companies Act will be applicable to these companies only to such extent as these are not inconsistent with those contained in the special Acts governing them (Sec. 616).

Registered companies can further be classified in two ways:

1. On the basis of number of members
2. On the basis of liability of members.

1. Types of registered companies on the basis of number of members

On the basis of the number of members a registered company may be: (i) private company or (ii) public company.

(i) Private company: According to Section 3(l)(iii), a 'private company' means a company which has a minimum paid-up capital of ` 1 lakh or such higher paid-up capital as may be prescribed, and by its articles of association:

(a) *Restricts* the right of the members to transfer shares, if any;

(b) *Limits* the number of its members to 50, excluding members who are or were in the employment of the company;

(c) *Prohibits* any invitation to the public to subscribe for any shares in, or debentures of, the company; and

(d) *Prohibits* any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

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The significance of the words *if any* used in sub-clause (a) above may be borne in mind. As a result of these words, the articles of association of a private company *having no share capital* shall have to place restrictions specified in the aforesaid sub-clauses (b), (c) and (d) only. In other words, in the case of a private company having no share capital, articles of association need not contain restriction regarding the right of the members to transfer shares.

For the purpose of counting the number of members in compliance of sub-clause (b) of the above definition, the Section further lays down that:

(i) Members who have been formerly in the employment of the company shall not be counted provided they were members while in that employment and have continued to be members after the employment ceased; and

(ii) Where two or more persons hold one or more shares of the company jointly, they shall be treated as a single member.

It is worth mentioning that the Companies (Amendment) Act, 2000, has, for the first time, prescribed capital adequacy norm for incorporation of companies so that only genuine companies with serious business intentions come into existence.

It may be noted that private companies existing on or before the date of commencement of the Amendment Act, 2000 (i.e., 13 December 2000), are also required is this requirement of minimum paid-up capital [sub-section 3]. However, a 'licensed company' registered under Section 25 has been exempted from complying with the requirement of minimum paid-up capital, as aforesaid [Sec. 3(6)].

The minimum number of members required to form a private company is 2. Such a company must add the word 'private' in its name. A private company enjoys some exemptions and privileges (i.e., some of the provisions of the Companies Act do not apply to such a company) which will be discussed later in this unit.

(ii) Public company: As per Section 3(1)(iv), a 'public company' means a company which:

(a) is not a private company;

(b) has a minimum paid-up capital of ₹5 lakh or such higher paid-up capital, as may be prescribed;

(c) is a private company which is a subsidiary of a company which is not a private company, i.e., which is a subsidiary of a public company.

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Elaborating Clause (a) of the above definition, a 'public company' is one, which:

(i) does not have any restriction on the transfer of shares, if any:
(ii) does not limit the maximum number of members,
(iii) can invite public for the subscription of its shares and debentures (of course it is under no obligation to invite public for this purpose if it is confident of obtaining the required capital privately); and
(iv) can invite or accept deposits from the public.

The Companies (Amendment) Act, 2000, has added Clauses (b) and (c) stated above in the definition of a 'public company'. Thus, all new public companies incorporated on or after the commencement of the Amendment Act (i.e., 13 December 2000), must have the minimum prescribed paid-up capital of `5 lakh. Further, a public company now *includes* a 'private company which is a subsidiary of a company which is not a private company'. As a result of this provision, a private company which is a subsidiary of public company shall become a public company on and from the commencement of the Amendment Act, 2000. Consequently, such a company will henceforth be regulated like a public company. It will, however, continue to retain the basic characteristics of a private company in terms of Section [3(1)(iii)].

It may further be noted that public companies existing on or before the date of commencement of the Amendment Act, 2000, are also required to meet their requirement of minimum paid-up capital [Sec. 3(3)]. However, a 'licensed company' registered under Section 25 shall not be required to have minimum paid-up capital as stated above [Sec. 3 (6)].

The minimum number of members required to form a public company is 7.

2. Types of registered companies on the basis of liability of members

On the basis of liability of members, the Companies Act, 1956, makes provision for the registration of three types of companies, namely:

i. Companies limited by shares, or
ii. Companies limited by guarantee, or
iii. Unlimited companies

Each of these types may be a 'public company' or a 'private company' (Sec. 12).

i. **Companies limited by shares:** A company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them is termed 'a company limited by shares' [Sec. 12(2)(a)]. Such a company is popularly called a *limited liability company.* The liability can be enforced at any time during the existence and also during the winding up of the company. Such a company must have share capital as the extent of liability is determined by the face value of

shares. Most of the companies in India are of this type and it is with companies of this class that we are mainly concerned.

ii. **Companies limited by guarantee:** A company limited by guarantee may be defined as 'a company having the liability of its members limited by its memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up' [Sec. 12(2)(b)]. The amount guaranteed by each member cannot be demanded until the company is wound up, hence it is in the nature of a 'reserve capital'. It is to be observed that in such types of companies the liability of the members can only be implemented after the commencement of winding up of the company; whereas in the case of companies limited by shares, the liability (if any) can be enforced at any time during the existence as well as during winding up of the company.

Such companies may or may not have share capital. However, they are formed generally without share capital for non-trading purposes, e.g., for the promotion of commerce, art, science, culture, sports, etc., because if they are formed for trading purposes, they must, in practice, possess a share capital for carrying on business, and the registration of a guarantee company with a share capital would be in no way better than registration in the ordinary way as a company limited by shares. The Chambers of Commerce, trade associations and sports clubs are usually guarantee companies because they neither require huge capital nor aim at making profit. The articles of association of such a company must state the number of members with which the company is to be registered.

iii. **Unlimited companies:** A company having no limit on the liability of its members is an unlimited company [Sec. 12(2)(c)]. Thus, the liability of members in such companies is unlimited, i.e., it may extend to the personal property of the members. Like a partnership, every member is liable to contribute, in proportion to his interest in the company, towards the amount required for payment *in full* of the total liabilities of the company, and if one is unable to contribute anything then the additional deficiency is to be shared among the remaining members in proportion to their capital in the company. However, it is different from an ordinary partnership in one important respect, i.e., creditors of such a company cannot sue members directly and they can only resort to the winding up of the company on default, the reason is that being a registered company it has a separate entity in law. It must be noted, however, that here also the liability of a member is enforceable only at the time of winding up.

Such a company may or may not have share capital. The articles of association of an unlimited company must state the number of members with which the company is to be registered and, if the company has a share capital, the amount of share capital with which the company is to be registered [Sec. 27(1)]. As the capital, if any, is stated in the articles and not in the memorandum, it may be

varied—increased or reduced—by passing a special resolution, without the sanction of the court (*Re Borough*, etc., *Building Society*). Again, an unlimited company is free from the restriction imposed by Section 77 and can purchase its own shares. Such companies are, however, rare these days.

7.2.3 Incorporation

A company is brought into existence by a legal process called incorporation. This is effected by registration with the Registrar of Companies. After completing the promotional work and before getting the proposed company actually registered the promoter takes the following preparatory steps:

(i) To ascertain from the Registrar of Companies whether the name by which the new company is to be started is available or not;

(ii) To get a Letter of Intent (to be converted later on into an Industrial Licence) under Industries (Development and Regulation) Act, 1951, if the company's business comes within the purview of the Act;

(iii) To fix up underwriters, brokers, bankers, solicitors, auditors and signatories to the memorandum;

(iv) To get Memorandum and Articles of Association prepared and printed.

After taking these preliminary steps, the promoter makes an application to the Registrar of Companies of the state in which the registered office of the company is to be situated, for registration of the company. The application must be accompanied by the following documents:

1. *Memorandum of association* duly stamped, signed and witnessed [Sec. 33(1)(a)].
2. *Articles of association* properly stamped, duly signed by the signatories of the Memorandum and witnessed. The filing of Articles is optional in the case of a public company with limited liability, which may adopt 'Table A', the model set of Articles, in its entirety. But where a public limited company adopts 'Table A', the fact must be specified on the Memorandum 'Registered without articles' which will mean automatic adoption of 'Table A'. For all other companies, filing of separate Articles is essential [Sec. 33(1)(b)].
3. The agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole-time director or manager [Sec. 33(1)(c)].
4. *A written consent of the directors* to act in that capacity, duly signed by each director, along with a written undertaking by them to take the necessary qualification shares, if any, as provided in the Articles [Sec. 266(1)]. *The document is, however, not to be filed in the case of*: (i) a company without share capital; (ii) a private company; and (iii) a company which was a private company prior to its becoming a public company [Sec. 266(5)].

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5. *The notice of address of the registered office* of the company. It may, however, be filed within 30 days of incorporation (Sec. 146).
6. *A statutory declaration* stating that all the legal requirements of the Act precedent to incorporation have been complied with. It must be signed by an advocate of the Supreme Court or of a high court, or by an attorney or a pleader entitled to appear before a high court, or by a secretary, or a chartered accountant, in whole-time practice in India, who is engaged in the formation of the company or by a person named in the Articles as a director, managing director, manager or secretary of the company [Sec. 33(2)].

Along with the above documents necessary filing fees and registration fees at the prescribed rates are also to be paid. Schedule X, given at the end of the Companies Act, prescribes the rates of filing fees and registration fees.

The Registrar will scrutinize these documents and if they are in order, he will register the company and will issue a *certificate of incorporation* (the company's 'birth certificate'). On obtaining this certificate, the company becomes a body corporate, with perpetual succession and a common seal [Sec. 34(2)].

The Registrar of Companies will allocate a Corporate Identity Number (CIN) to each company registered on or after 1 November 2000. Further, the Government [Department of Company Affairs' (DCA)] has decided that all companies registered under the Companies Act, 1956, prior to 1 November 2000 will be allotted a CIN within a year up to April 2002 in a phased manner. The DCA has directed all Registrar of Companies (ROCs) to act accordingly.

Share Capital

Every company limited by shares must have a share capital. Share Capital of a company refers to the amount invested in the company for it to carry out its operations. The share capital may be altered or increased, subject to certain conditions. A company's share capital may be divided into small shares of different classes. The different classes of share capital and the rights attached to these classes are different.

Nature of Shares

A share is the interest of a member in a company. Section 2(84) of the Companies Act, 2013 (hereinafter referred to as Act) "share" means a share in the share capital of a company and includes stock. It represents the interest of a shareholder in the company, measured for the purposes of liability and dividend. It attaches various rights and liabilities.

Share, debentures or other interest of any member in a company shall be movable property. It shall be transferable in any manner provided for in the articles of association of the company. A member may transfer any "other interest" in the company in the manner provided in the articles. For example rights attached to a

member in a guarantee company such as membership interest, suspension of membership or assignment of interest may be made transferable by making a provision in the Articles of the company.

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Check Your Progress

1. What do you mean by a company?
2. List the essential characteristics of a company.
3. List types of registered companies on the basis of number of members.
4. What do you mean by incorporation?

7.3 MEETINGS, COMPANY MANAGEMENT AND RESOLUTION

Meetings are the opportunities provided to the shareholders to let them know about the working of the company. Thus, shareholders gather together and review the progress of the company. A statutory meeting is a must for all public companies which have a share capital except unlimited companies. Before the conduction of the meeting a statutory report is to be send to all the members, at least 21 days before the meeting.

Meetings that are held each year to review to progress of the company are called annual general meetings. Voting is a way of knowing about the general sense of all the members on any particular proposal that has been made in a meeting. Voting is done using various methods, such as showing hands, by poll, etc.

7.3.1 General Meetings

Meetings of shareholders are called *general meetings*. Such meetings are of vital importance in the working of a company. For, although the general powers of management of a company are vested in the Board of Directors, the consent of members on such major issues as specified in Section 293 (already discussed in the preceding unit) has to be obtained in their general meeting. Also, it is fair to provide an opportunity to the shareholders to come together and review the working of the company. Hence, the Companies Act has provided for various types of meetings of the shareholders of a company.

7.3.2 Types of General Meetings

There are three types of general meetings of shareholders:

(i) Statutory meeting
(ii) Annual general meetings
(iii) Extraordinary general meetings

In addition to the above types of meetings, sometimes a meeting of a particular class of shareholders may also be held. Such meetings are called *class meetings*. They are convened either by the company or by the court to affect variations in the rights of that particular class of shareholders (Sec. 106) or in connection with a scheme of arrangement (Sec. 394) or at the time of winding up of the company. A class meeting is not a general meeting, but similar rules relating to convening and conducting of a meeting apply to it (Sec. 170).

(i) Statutory meeting

It is the first official general meeting of the shareholders. All public companies having share capital except unlimited companies are required to hold a statutory meeting compulsorily. It implies that private companies, unlimited companies, and companies limited by guarantee but not having a share capital are not required to hold such a meeting. Statutory meeting must be held after one month but within six months of obtaining the 'certificate to commence business' [Sec. 165(1)]. Unlike other types of general meetings, this meeting is held only once in the lifetime of a company.

The object of the statutory meeting is to provide an opportunity to the members, as early as possible, of acquainting themselves with the assets and properties acquired so far and to discuss the success of the flotation. The members are free to discuss any matter relating to the formation of the company or arising out of the statutory report. But they cannot pass any resolution without previous notice of at least 21 days [Sec. 165(7)].

Statutory report: In order to enable the members to make the best use of this opportunity, the directors are required to prepare and send to every member a document known as the 'statutory report' at least 21 days before the day on which the meeting is to be held. If the report is sent later it will still be valid if it is so agreed to by a unanimous vote of the members entitled to attend and vote at the meeting [Sec. 165(2)]. The report should be certified as correct by at least two directors, one of whom shall be the managing director where there is one and must also be certified by the auditors [Sec. 165(4)]. A copy of this report must be filed with the Registrar forthwith at the time of sending it to the members [Sec. 165(5)].

The statutory report must set out the following information:

(i) The total number of shares allotted, distinguishing those issued otherwise than for cash and stating in the case of partly paid up shares, the extent to which they are so paid;

(ii) The total amount of cash received by the company in respect of all the shares allotted;

(iii) An abstract of the receipts and payments up to a date within seven days of the report and the balance in hand. The abstract must show, under distinctive headings, the receipts of the company from shares, debentures and other sources and shall give an account or estimate of the preliminary

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expenses of the company showing separately any commission or discount paid or to be paid on the issue or sale of shares or debentures;

(iv) The names, addresses and occupations of the company's directors, auditors, managing director or manager and secretary and the changes, if any, that have occurred since incorporation;

(v) The particulars of any contract to be submitted to the meeting for approval and its modification done or proposed, if any;

(vi) The extent to which any underwriting contract has not been carried out and the reasons therefor;

(vii) The details of arrears of calls due from directors and managing director or manager; and

(viii) The particulars of any commission or brokerage paid or to be paid to directors and manager in connection with the sale of shares or debentures of the company.

If any default is made in filing the statutory report with the Registrar or in holding the statutory meeting, every director or other officer of the company responsible for the default shall be punishable with a fine up to ₹ 5,000 [Sec. 165(9)]. Further, if the statutory meeting is not held in time, the court may, under Section 433, order the compulsory winding up of the company, on a petition filed by the Registrar or by any member after the expiry of 14 days from the date on which the statutory meeting was to be held [Sec. 439(7)].

(ii) Annual general meeting

Every company must, in each year, hold in addition to any other meetings a general meeting as its annual general meeting [Sec. 166(1)]. It is the most important meeting of the members of a company. It is held each year with a view to reviewing and evaluating the overall progress of the company during a year. The annual general meeting is sometimes called 'ordinary general meeting' as it usually deals with the so-called 'ordinary business.' The following *ordinary business* must be transacted at the annual general meeting of a public company [Sec. 173(1)(a)]:

(i) The consideration of the Annual Accounts, Balance Sheet and the Reports of the Board of Directors and Auditors

(ii) The declaration of a dividend

(iii) The appointment of directors in the place of those retiring

(iv) The appointment of, and the fixation of the remuneration of, the auditors

Any other business on agenda except the above-mentioned ones shall be considered as *special business* and may also be transacted at the annual general meeting, provided appropriate notice has been given. It is to be noted that in the case of extraordinary general meetings all business shall be treated as 'special business' [Sec. 173(1)(b)]. It is relevant to state that the 'ordinary business' requires an ordinary resolution while the 'special business' may require ordinary or special

resolution as per articles or the Act. A special resolution is, however, required for any appointment of auditors, although it is an item of ordinary business, in the case of a company in which not less than 25 per cent of the subscribed share capital is held, whether singly or jointly by a public financial institution or a Government company or Central Government or any state Government or a nationalized bank or a general insurance company (Sec. 224-A).

It may be noted that a private company may make its own provisions by its articles in respect of 'ordinary business' to be transacted at an annual general meeting [Sec. 170(1)(ii)].

Other statutory requirements: The Companies Act imposes the following obligations on *every* company, public or private, as regards convening of the annual general meetings:

1. The first annual general meeting of a company must be held within eighteenth months from the date of its incorporation, and if such a general meeting is held within that period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation or in the following year. It may be noted that there can be no extension of period beyond 18 months in case of this meeting even by the Registrar [Sec. 166(1)].
2. Subsequent annual general meetings must be held each year *within six months* of the end of the company's financial year [Sec. 210(3)(b)], but the interval between any two annual general meetings must not be *more than* 15 *months.* The Registrar may, however, for any special reason extend the above time by a period not exceeding three months [Sec. 166(1)].

   In connection with subsequent annual general meetings, it is worth noting that the holding of an annual general meeting in each calendar year is a statutory necessity, and it is not enough that they are held within 15 months of each other. 'There should be one meeting per year and as many meetings as there are years' (*Shri Meenakshi Mills Co. Ltd vs Assistant Registrar of Joint Stock Companies*). Further, though the annual general meeting of a company may be adjourned to a subsequent date and the adjourned meeting is to be deemed to be a continuation of the earlier meeting, the adjourned meeting too must be held within 15 months of the previous meeting (*Bejoy Kumar Karnani vs Asst. Registrar of Companies*).
3. The annual general meeting must be held on a day that is not a public holiday during business hours at the registered office of the company or at some other place within the city where the registered office of the company is situated [Sec. 166(2)].
4. At least 21 day's written noticeto call an annual general meeting must be given to every shareholder, directors and auditors of the company, and to every such person on whom the shares of any deceased or insolvent member may have devolved [Sections 171(1) and 172(2)]. The meeting may be held with a shorter notice, if it is so agreed unanimously by all members

entitled to vote in such a meeting [Sec. 171(2)]. A private company may, however, by its articles make its own regulations as regards length of period of notice and to whom it should be given [Sec. 170(1)(ii)].

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A copy of Directors' Report, audited Annual Accounts and Auditors' Reportmust be annexed to every such notice [Sec. 219(1)].

The holding of annual general meeting is also governed by Sections 171 to 186 which contain provisions relating to convening and conducting of all types of general meetings under the Act.

Default in holding the annual general meeting*:* If a company fails to call an annual general meeting within the prescribed time limits, the Company Law Board may, on the application of any member of the company, call or direct the calling of the meeting and give such ancillary or consequential directions as it thinks expedient in relation to the calling, holding and conducting of the meeting. The directions that may be given by the Company Law Board may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting (Sec. 167).

Further, the company and every officer who is in default is liable to a fine which may extend to ₹ 50,000 and in the case of a continuing default, with a further fine which may extend to ₹ 2,500 for every day after the first during which such default continues (Sec. 168).

(iii) Extraordinary general meeting

All general meetings other than the statutory and annual general meetings are called extraordinary general meetings. Regulation 47 of 'Table A' defines: 'All general meetings other than annual general meetings shall be called extraordinary general meetings'. These meetings may be convened by the company at any time. The business transacted at an extraordinary general meeting comprises anything which cannot be postponed till the next Annual General Meeting, such as, changes in memorandum and articles of association, reduction and reorganization of share capital, issue of debentures, etc. All business transacted at this meeting is called 'special business' [Sec. 173(1)(b)]. The convening and conducting of this meeting is governed, like the annual general meeting, by Sections 171 to 186.

Extraordinary general meetings may be called:

1. ***By the directors:*** The directors, may, whenever they think fit, convene an extraordinary general meeting by passing a resolution to that effect in the Board's meeting.
2. ***By the directors on requisition (Sec. 169):*** The directors must convene an extraordinary general meeting on the requisition (written demand) of members holding not less than one-tenth of the total voting rights on the matter of requisition. The requisition must state the matters for the consideration of which the meeting is to be called. It must be

signed by the requisitionists and deposited at the registered office of the company. The directors should within 21 days from the date of the deposit of a valid requisition, move to call a meeting and should give 21 days' notice to members for calling such a meeting and the meeting should actually be held within 45 days from the date of the requisition.

It may be noted that the requisitionists are not bound to disclose reasons for the resolution they propose to move at the meeting (*Life Insurance Corporation vs Escorts Ltd*). Further, no business other than the business for which the meeting has been expressly convened can be transacted at the requisitioned meeting.

3. ***By the requisitionists themselves (Sec. 169):*** If the directors fail to call the meeting within aforementioned time limits, the requisitionists or such of the requisitionists as represent not less than one-tenth of the total voting rights of all the members, may themselves convene a meeting within three months of depositing the requisition. Such a meeting should be called in the same manner, as nearly as possible, as that in which meetings are called by the Board. Any reasonable expenses incurred by the requisitionists must be repaid to them by the company, and any sum so paid shall be retained by the company out of any sums due or likely to become due to the directors by default.
4. ***By the Company Law Board (Sec. 186).*** If for any reason it is impracticable to call or conduct an extraordinary general meeting, the Company Law Board may, either of its own motion or on the application of any director or any member who would be entitled to vote, order a meeting to be called, held and conducted in such manner as the Company Law Board thinks fit and may give such directions as it thinks expedient, including a direction that one member present in person or by proxy shall be deemed to constitute a meeting.

It may be noted that unlike an annual general meeting an extraordinary general meeting can be convened on a public holiday and at a place other than the registered office of the company or the city in which the registered office is situated.

7.3.3 Requisites of a Valid Meeting

A general meeting of shareholders is said to be valid when it is properly convened (i.e., when proper notice is issued by a proper authority to all those entitled to receive the notice) and legally constituted (i.e., when there is a proper person in the chair, requisite quorum is present and the provisions of the Act and the articles are complied with). For transacting legally binding business, the meeting must be validly held. Any irregularity in convening or conducting the meeting shall invalidate the proceedings of the meeting. Such an invalidation, however, does not affect the interests of third parties, who have no notice of the irregularity, on the principle of Indoor Management' as laid in the case of *Royal British Bank vs Turquand*).

Sections 171 to 186 of the Companies Act contain provisions relating to the holding of valid general meetings which must be *compulsorily* followed by every public company, in addition to any other rules provided in the articles of the company [Sec. 170(1)(i)]. A private company is free to make its own regulations by its articles with respect to general meetings and the provisions of Sections 171 to 186 shall apply to such a company only if its articles do not provide otherwise [Sec. 170(1)(ii)].

The following are the requisites of a valid general meeting as per the Companies Act:

1. ***Proper convening authority***: A valid meeting must be called by a proper authority. The proper authority to convene a general meeting of shareholders is the directors who should pass a resolution at a Board meeting for the same. Of course in the event of default by the directors, the requisitionists or the Company Law Board shall become the proper authority to call such a meeting. It may be noted that the resolution to call a general meeting must be passed at a valid Board's meeting, otherwise, the notice calling the general meeting will itself become invalid and the proceedings of the meeting shall not be effective (*N.V.R. Nagappa Chettiar vs The Madras Race Club*).
2. ***Proper notice:*** A proper notice of the meeting must be given to every shareholder (equity and preference), auditors of the company, each director of the company and to every such person who is entitled to attend the meeting, i.e., the persons on whom the shares of any deceased or insolvent member may have devolved. Deliberate omission to give notice to even a single member may invalidate the meeting, although an accidental omission to give notice to, or the non-receipt of notice by, any member or other persons to whom it should be given shall not invalidate the proceedings of the meeting [Sec. 172(2)(3)].

   The notice should be in writing and must be given at least 21 days before the date of the meeting (Sec. 171). In calculating 21 days, 48 hours from the date of posting should be excluded (Sec. 53).

   The notice must specify the place, day and hour of the meeting, and must contain an 'agenda', namely a statement of the business to be transacted at the meeting [Sec. 172(1)]. It must also specify the date of notice, the name of the company, the type of meeting, the exact wording of any proposed resolution, the authority by which notice is issued and the name of the person issuing the notice. In the case of special business, there must be annexed to the notice of the meeting an explanatory statement mentioning all the material details concerning each such item of business, including in particular the nature of interest, if any, therein of every director or other managerial personnel [Sec. 173(2)]. The notice must also state that a member is entitled to appoint a proxy, where allowed under the Act or the articles, and that a proxy need not be a member [Sec. 176(2)]. The object of mentioning the

various items of business in the Notice is to give the persons concerned sufficient opportunity to consider the different items before they come for discussion in the general meeting.

The notice may be sent to a member either personally or by post, to his registered address, or the address given by him for sending the notices to him, in India. The notice sent by post should be properly addressed, prepaid and posted. A notice may be sent to the joint-holders of shares by serving it on the joint-holder named first in the Register of Members in respect of those shares (Sec. 53).

3. ***Requisite quorum***: The third important condition for a valid meeting is that the quorum must be present. A quorum is the specified minimum number of qualified persons (members) whose presence is necessary for transacting legally binding business at the meeting. The members constituting the quorum must be effective members entitled to vote at the meeting. Where no quorum is present the meeting is not legally constituted and the business transacted at the meeting or any resolution passed thereat becomes invalid. However, third parties without notice are not affected by reason of any irregularity in the quorum (*County of Gloucester Bank vs Rudry Morthyr*).

   Section 174(1) of the Act prescribes the minimum number of members who shall constitute the quorum of general meetings. The sub-section states that unless the articles provide for a larger number, the quorum shall be *two members personally present* in the case of a private company, and *five members personally present* in the case of a public company for all general meetings of the members. The following further points are to be noted as regards quorum of a general meeting:

   - The articles cannot provide for a smaller quorum than fixed by the Act but can provide for a larger number to constitute the quorum.
   - Only members present in person, and not proxies, can be counted for purposes of quorum.
   - A person appointed as a representative of a company, which is a member of the company, is deemed to be personally present for the purpose of quorum [Sec. 187(2)].
   - A nominee of the President of India or the Governor of a state, where the latter holds shares in a company, shall be counted towards the number forming the quorum (Sec. 187A).
   - Joint-holders of shares are treated as one member for the purpose of quorum.
   - If the total number of members of a company is reduced below the quorum fixed by the Articles, the rule as to quorum may be deemed to be satisfied if all the members, though less than the quorum, are present.

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- If business proposed to be transacted at a general meeting does not include any item or resolution proposed to be passed, which directly affects the rights of the preference shareholders, their presence should not be taken into account for purpose of determining the quorum, but where the subject matter includes any resolution in which the rights of preference shareholders are directly affected, their presence should be taken into account for the purpose of the quorum.
- There is always a presumption as to the existence of the quorum unless the records of the meeting show anything to the contrary.

The Act is silent on the point of 'time of presence' of the quorum at the meeting. Regulation 49(1) of Table A, however, states: 'No business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business.' It follows from these wordings that quorum is required to be present at the beginning of meeting. It need not be present throughout or at the time of taking votes on any resolution. Similar ruling was given in *Hartley Baird Ltd* case. It may be recalled that a quorum must be present throughout in the case of Board's meeting.

Regarding the procedure for observing quorum, Section 174 states that unless the articles provide otherwise, the following provisions shall apply to every company, public or private:

(a) If within half an hour from the time announced for holding a meeting of the company, a quorum is not present, the meeting, if called upon the requisition of members, shall stand dissolved. In any other case, the meeting shall stand adjourned to the same day in the next week at the same time and place unless the Board of Directors determine otherwise.

(b) If at the adjourned or the reassembled meeting also, a quorum is not present within half-an-hour from the time announced for holding the meeting, the members present shall be a quorum.

4. ***Proper Chairman:*** The fourth requisite for a valid meeting is that there must be a Chairman to preside over the proceedings of the meeting. In this regard, Section 175 lays down:

- Unless the articles of a company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the chairman thereof on a show of hands.
- If a poll is demanded on the election of the chairman, it shall be taken forthwith in accordance with the provisions of this Act, the chairman elected on a show of hands exercising all the powers of the chairman under the said provisions.
- If some other person is elected chairman as a result of the poll, he shall be the chairman for the rest of the meeting.

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It may, however, be noticed that this Section leaves the appointment of the chairman to be regulated by the articles of the company and the provisions of this Section shall apply only if the articles do not otherwise provide. The articles generally contain provisions on the lines of 'Table A'—Regulations 50–52. These Regulations are reproduced below:

Regulations 50: The chairman, if any, of the Board shall preside as chairman at every general meeting of the company.

Regulations 51: If there is no such chairman, or if he is not present within 15 minutes after the time appointed for holding the meeting, or is unwilling to act as chairman of the meeting, the directors present shall elect one of their number to be chairman of the meeting.

Regulations 52: If at any meeting no director is willing to act as chairman or if no director is present within 15 minutes after the time appointed for holding the meeting, the members present shall choose one of their number to be chairman of the meeting.

Duties and powers of the chairman: The chairman of a general meeting is responsible for conducting the business at the meeting successfully. He must preserve order in the meeting. He must ensure that the business is within the scope of the meeting and that the sense of the meeting is properly ascertained. He must act impartially and must not abuse his powers.

The chairman has *prima facie* authority to decide all incidental questions which arise at the meeting. But he has no power to stop or adjourn a meeting unless there is absence of quorum or there is disorder or there remains some with the articles. If he wrongly adjourns the meeting, the meeting may appoint another chairman and continue the business (*Narayanan Chettiar vs Kaleshwar Mills Ltd*). He has also no power to change the order of the items of business to be transacted at the meeting as set out in the Agenda. However, the order of items on the Agenda may be changed with the consent of the meeting, if necessary. Again, the chairman has no right to prevent discussion upon a mater which forms part of the notice convening the meeting. Of course he may refuse a member to talk as much as he likes.

Note that the chairman is entitled to a casting or second vote in the case of an equality of votes, unless the articles of the company specifically provide otherwise.

We will discuss meetings in detail in the final unit of the book.

7.3.4 Voting

The word 'vote' means an expression of a wish or opinion in an authorized formal way for or against any proposal. After a 'proposed resolution' or a 'motion' has been discussed in the meeting by the members it is put to vote for ascertaining the sense of the house. The 'articles' prescribe regulations and procedure for voting at general meetings subject to the provisions of the Act.

A. Voting rights

Every holder of 'equity shares with voting rights', whose name appears on the register of members has the right to vote on every resolution placed before the company at a general meeting. In other words, the holder of such equity shares possesses *normal voting rights.* Further, his voting rights on a 'poll' (a method of voting) shall be in proportion to his share of the paid-up equity capital of the company [Sec. 87(1)].

The preference shareholders *do not possess normal voting rights*. They are, however, entitled to vote in the following two cases:

(i) When any resolution directly affecting their rights is to be passed. It is worth noting here that any resolution for winding up of the company or for the repayment or reduction of its share capital is to be regarded as a resolution directly affecting the rights of the preference shareholders, and therefore they are entitled to vote on such a resolution.

(ii) When the dividend due (whether declared or not) on their preference shares or part thereof has remained unpaid:

(a) in the case of *cumulative preference shares,* for an aggregate period of not less than two years preceding the date of the meeting; and

(b) in the case of *non-cumulative preference shares,* either for a period of two consecutive years or for an aggregate period of not less than three years comprised in the six years ending with the expiry of the financial year immediately preceding the date of the meeting.

It may be observed that when the dividend due on their preference shares has remained unpaid for periods specified above, the preference shareholders become entitled to vote on *every resolution* placed before the company at any general meeting.

The Act further provides that where a preference shareholder has a right to vote on any resolution in accordance with the provisions mentioned above, his voting right on a 'poll' shall be in the same proportion as the capital paid up in respect of the preference shares bears to the total paid up equity capital of the company [Sec. 87(2)]. It is important to note that the above provisions relating to voting rights of preference shareholders do not apply to a private company. Such a company can issue preference shares carrying normal voting rights or even disproportionate voting rights [Sec. 90(2)].

In the case of joint shareholders, the vote of the senior joint-holder (whose name appears first in the register of members) shall be accepted. An insolvent shareholder is entitled to exercise the votes which are attributed to his status as a member provided his name appears on the Register of Members (*Morgan vs Gray*).

In the case of a public company, any restriction in the articles of the company on a member's right to vote, except on the ground of non-payment of calls or other sums due against him, shall be void (Sections 181 and 182). A member can exercise his right to vote for his own interest and even against the interests of the company (*Greenwell vs Porter*).

B. Methods of voting

Voting at a general meeting takes place by: (i) show of hands, and (ii) poll. Voting by secret ballot is not allowed by the Companies Act. However, in case of licensed companies under Section 25 of the Act, i.e., companies not carrying on business for profit or prohibiting the payment of a dividend to their members, such as clubs, chambers of commerce, etc., voting by 'ballot' can be provided by their articles (Sec. 263A).

i. **Voting by poll and voting by secret ballot distinguished**: We have observed earlier that the Companies Act prohibit voting by secret ballot. The differences between voting by poll and voting by secret ballot must, therefore, be noted. Where each member has one vote and voting is secret it is called 'voting by secret ballot'. In case of a poll each member has votes in proportion to his shareholding and the voting is not secret. The members are required to sign on the vote cards. Again, proxies are not allowed in voting by secret ballot whereas they are allowed in a poll.

ii. **Who can demand a poll? (Sec. 179):** A poll may be ordered by the chairman of his own motion. But he shall be bound to take a poll if demanded:
   (a) in case of a public company having share capital, by any member or members, having the right to vote on the resolution and present in person or by proxy, holding at least one-tenth of the total paid-up capital of that class, or holding shares of the paid-up value of at least ₹50,000;
   (b) in the case of a private company having share capital, by one member entitled to vote on the resolution and present in person or by proxy if not more than seven such members are personally present, and by two such members present in person or by proxy if more than seven such members are personally present;
   (c) in the case of any other company, by any member or members present in person or by proxy holding at least one-tenth of the total voting power regarding the particular resolution.

The demand for a poll may be withdrawn at any time by the person or persons who made the demand. When a poll is taken a member is free to split his votes for and against the same resolution. He has the right to distribute his votes in any manner he likes (Sec. 183). When more than one resolution is to be passed, poll is to be taken on each separately.

A poll demanded on a question of adjournment or the election of a chairman must be taken forthwith. In any other case, it must be taken within 48 hours of the

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demand for poll (Sec. 180). When a poll is to be taken the chairman of the meeting shall appoint two scrutineers, one of whom should be a member of the company, to scrutinise the votes given on the poll and to report thereon to him (Sec. 184). The chairman of the meeting shall have the power to regulate the manner in which a poll shall be taken. The result of the poll shall be deemed to be decision of the meeting on the resolution on which the poll was taken (Sec. 185). The declaration of the result by the chairman and an entry to that effect in minutes' books of the company is conclusive and final (Sections 194 and 195).

C. Proxies

A proxy is a member's authorized agent for the purpose of voting. The term is also applied to the instrument by which the appointment to act on his behalf is made by the member. As per Section 176, the provisions relating to proxies are as follows:

1. Members of a company having share capital have a statutory right to appoint proxies, notwithstanding anything to the contrary in the articles. In other companies, proxies may be appointed if allowed in the articles.
2. Unless the articles otherwise provide, a proxy shall not be allowed to vote except on a poll.
3. Unless the articles otherwise provide, a member of a private company is not entitled to appoint more than one proxy to attend on the same occasion. (For every resolution, poll is taken separately and for every resolution separate proxy may be appointed in a public company).
4. A proxy must be in writing in the proper form duly signed by the appointer and stamped. If the appointer is a body corporate the instrument of proxy should be under its seal and be signed by a duly authorised officer.
5. A proxy may be lodged at the company's registered office not later than 48 hours before the commencement of the meeting. If the articles of a company, other than a private company, require a longer period than 48 hours, that will be inoperative and the shareholders will have the right to deposit proxies 48 hours before the meeting.
6. For each meeting a separate proxy is required.
7. A proxy need not be a member of the company.
8. A proxy shall not have any right to speak at the meeting.
9. Every notice calling a general meeting must state with reasonable prominence that a member is entitled to appoint a proxy and that the proxy need not be a member. If default is made in complying with this provision every defaulting officer is punishable with a fine up to ‘ 5,000.
10. No invitation to appoint any person as proxy shall be issued at company's expense and if any such invitation is issued every officer of the company who is knowingly in default shall be punishable with fine which may extend to ₹ 10,000.

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11. After giving three days' notice to the company, members may inspect proxies lodged with the company during 24 hours (within business hours) before the time fixed for the meeting and till the conclusion of the meeting.
12. Subject to the provisions in the articles, a proxy can be revoked by intimating the company, at any time, before it is acted upon. Death or insanity of the principal also revokes the authority of the proxy but proper intimation to the company is necessary. Moreover, a member can prevent the proxy from exercising the right to vote by himself attending and voting at the meeting.
13. Where a company is a member of another company or where the Government is a member of a company, their properly appointed representative enjoys all the rights of a member. He can speak at the meeting and vote on a show of hands as well as on a poll [Sections 187(2) and 187 A(2)].

It may be noted that a private company is free to make its own provisions by its articles as regards 'proxies' and the provisions of Section 176 (as stated above under points 1 to 11) shall apply to such a company only if its articles do not otherwise provide [Sec. 170(i)(ii)].

Check Your Progress

5. What is the role of meetings in a company?
6. List the various types of general meetings.
7. What do you mean by 'voting rights' in a company?

7.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Section 3(l)(i) and (ii) of the Companies Act, 1956, define a company as 'a company formed and registered under this Act or an existing company. An 'existing company' means a company formed and registered under any of the former Companies Acts'.A company may be defined as an incorporated association, which is an artificial legal person, having a separate legal entity, with a perpetual succession, a common seal, a common capital comprising transferable shares and carrying limited liability.
2. The essential characteristics of a company are:
   (i) Incorporated association
   (ii) Artificial legal person
   (iii) Separate legal entity
   (iv) Perpetual existence
   (v) Common seal

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(vi) Limited liability

(vii) Transferability of shares

3. On the basis of the number of members a registered company may be: (i) private company or (ii) public company.
4. A company is brought into existence by a legal process called incorporation. This is effected by registration with the Registrar of Companies.
5. Meetings are the opportunities provided to the shareholders to let them know about the working of the company. Thus, shareholders gather together and review the progress of the company. A statutory meeting is a must for all public companies which have a share capital except unlimited companies. Before the conduction of the meeting a statutory report is to be send to all the members, at least 21 days before the meeting. Meetings that are held each year to review to progress of the company are called annual general meetings
6. There are three types of general meetings of shareholders:

   (i) Statutory meeting

   (ii) Annual general meetings

   (iii) Extraordinary general meetings

   In addition to the above types of meetings, sometimes a meeting of a particular class of shareholders may also be held. Such meetings are called class meetings.
7. Every holder of 'equity shares with voting rights', whose name appears on the register of members has the right to vote on every resolution placed before the company at a general meeting. In other words, the holder of such equity shares possesses normal voting rights. Further, his voting rights on a 'poll' (a method of voting) shall be in proportion to his share of the paid-up equity capital of the company [Sec. 87(1)].

7.5 SUMMARY

- The Companies Act, 1956, constitutes the Company Law in India. It contains elaborate provisions relating to the formation, powers and responsibilities of the directors and managers, raising of capital, holding of company meetings, maintenance and audit of company accounts, powers of inspection and investigation of company affairs, and winding up of companies. The Act contains 658 Sections and XV Schedules.
- A company must necessarily be incorporated or registered under the prevalent Companies Act. Registration creates a joint stock company and it is compulsory for all associations or partnerships, having a membership of

more than 10 in banking and more than 20 in any other trading activity, formed for carrying on a business with the object of earning profits

- A company registered under the Companies Act is known as 'incorporated' or 'registered' company. All existing companies in India, except the statutory companies, have been formed in this way and are governed by the provisions of the Companies Act, 1956.
- A company may be incorporated either by a special Act of legislature or under the Companies Act and accordingly a company may be statutory or incorporated.
- On the basis of the number of members, a registered company may be private or public.
- On the basis of liability of members, the Companies Act makes provision for the registration of three types of companies, namely:
  - o Companies limited by shares.
  - o Companies limited by guarantee.
  - o Unlimited companies.
- A private company may either automatically become a public company or can be deliberately convened into a public company.
- A company is brought into existence by a legal process called 'incorporation'. This is effected by registration with the Registrar of Companies.
- Meetings that are held each year review to progress of the company are called 'annual general meetings'. Voting is a way of knowing about the general sense of all the members on any particular proposal that has been made in a meeting. Voting is done using various methods, such as showing hands, by poll, etc.
- Voting at a general meeting takes place by: (i) show of hands, and (ii) poll. Voting by secret ballot is not allowed by the Companies Act. However, in case of licensed companies under Section 25 of the Act, i.e., companies not carrying on business for profit or prohibiting the payment of a dividend to their members, such as clubs, chambers of commerce, etc., voting by 'ballot' can be provided by their articles (Sec. 263A).
- Section 408, as amended by the Companies (Amendment) Act, 1988, has further empowered the Central Government to interfere for preventing oppression or mismanagement. Accordingly, the Central Government may appoint such number of directors as the Company Law Board may, by order in writing, specify as being necessary to effectively safeguard the interests of the company, or its shareholders, or the public interest, for a period not exceeding three years on any one occasion.

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7.6 KEY WORDS

- **Company:** It means an incorporated association, which is an artificial legal person, having a separate legal entity, with a perpetual succession, a common seal, a common capital comprising transferable shares.
- **Private company:** This is a company which has a minimum paid-up capital of ₹ 1 lakh or such higher paid-up capital as may be prescribed, by its articles of association.
- **One-man company:** Where one man holds practically the whole of the share capital of a company and takes a few more dummy members simply to meet the statutory requirement of the minimum number of persons such a company is known as 'one-man company'.

7.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the Companies Law in India.
2. Write in brief about the incorporated or registered company.
3. Write in short about companies limited by shares.
4. Write a short note on the special provisions of the Companies Act relating to Government companies.
5. Write in brief about the role of general meetings in a company.
6. Write a short note on requisites of a valid meeting.

Long-Answer Questions

1. "A company is an artificial legal person." Justify this statement.
2. Discuss the various types of companies under the Companies Act, 1956.
3. Analyse the significance of the Company Law Board in companies' affairs.
4. Analyse the provisions relating to proxies as given in the companies Act, 1956.

7.8 FURTHER READINGS

Kuchhal, M.C. and Vivek Kuchhal. 2013. *Business Law,* sixth edition. Delhi: Vikas Publishing House.

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UNIT 8 CONSUMER PROTECTION ACT (COPRA), 1986

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Structure

8.0 INTRODUCTION

The law relating to 'consumer protection' is contained in Consumer Protection Act, 1986. This Act, 1986 was enacted to meet the long-felt necessity of protecting the consumers from getting cheated by unscrupulous suppliers of goods and services for which remedy under various existing laws like the Sale of Goods Act, the Prevention of Food Adulteration Act, the Standards of Weights and Measures Act, the Dangerous Drugs Act, etc., have become illusory. These laws require the aggrieved consumer to initiate action by way of a civil suit involving expensive and time-consuming legal processes. It is a known fact that in the Civil Courts, judgement in a suit takes years. The Consumer Protection Act, 1986 attempts to provide an inexpensive, simpler and quicker access to redressal of consumer grievances. The Act has provided a machinery whereby consumers can file their complaints against defective goods or deficient services with Consumer Forums, namely, the District Forum at the District level, State Commission at the State level and National Commission at the National level. The Act provides for an alternative system of consumer justice by summary trial. There is no need to engage a lawyer to present the case and there is a time limit for disposal of a case.

This unit aims at analysing the 'Consumer Protection Act of 1986', explains the various provisions of the Act and brings in an in-depth discussion on redressal mechanism for consumers.

8.1 OBJECTIVES

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After going through this unit, you will be able to:

- Understand the objectives of Consumer Protection Act, 1986
- Explain the meaning of consumer
- Understand the redressal of complaints
- Enumerate the role of consumer protection councils
- Explain the functioning of consumer disputes redressal agencies
- Understand the composition of state and nation commissions

8.2 CONSUMER PROTECTION ACT, 1986: BACKGROUND AND DEFINITIONS

The Consumer Protection Act, 1986 is one of the benevolent pieces of legislation intended to protect a large body of consumers from exploitation. It aims to protect the interests of consumers by recognising them in the form of rights. The various rights of consumers recognized under the Act which are to be promoted and protected by the Consumer Protection Councils are as follows:

i. Right to safety: To be protected against the sale of goods and services which are spurious or hazardous to life and property.

ii. Right to information: To be informed about the quality, quantity, weight and the price of goods or services being paid for, so that they are not cheated by unfair trade practices.

iii. Right to choose: To be assured, wherever possible, access to a variety of goods and services at a competitive price.

iv. Right to be heard: To be heard and to be assured that their interest will receive due consideration at appropriate forums.

v. Right to seek redressal against exploitation: To seek legal redressal against unfair or restrictive trade practices or exploitation.

vi. Right to consumer education: To have access to consumer education. Unless the consumers are aware of their rights and remedies, protection of their interest shall remain a myth.

8.2.1 Scope and Applicability of the Act

The Consumer Protection Act, 1986 extends to the whole of India except the State of Jammu and Kashmir. The Act applies to all goods and services except those notified by the Central Government (Sec. 1). The provisions of the Act are in addition to and not in derogation of the provisions of any other law (Sec. 3). As such, the provisions of the Act grant additional remedy to the consumers. Thus, an

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arbitration clause in an insurance policy is no bar to a proceeding under the Consumer Protection Act.

8.3 UNDERSTANDING THE MEANING OF CONSUMER

According to Sec. 2 (1) (d), a 'consumer' means:

(*i*) Any person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment, and includes any person who uses such goods with the approval of the buyer. It does not include a person who buys goods for resale or for any commercial purpose; *or*

(*ii*) Any person who hires or avails any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment, and includes any person who is a beneficiary of such services with the approval of the hirer. It does not include a person who avails of such services for any commercial purpose.

For the purposes of this clause, 'commercial purpose' does not include use by a person of goods bought and used by him and services availed by him exclusively for the purpose of earning his livelihood, by means of self-employment.

The term 'person' includes a firm, Hindu Undivided Family, company, cooperative society, and every other association of persons whether registered under the Societies Registration Act, 1860 or not.

8.3.1 Types of Consumers

It may be observed that the above definition of the term 'consumer' is in two parts:

I. Consumer of goods.

II. Consumer of services.

I. Consumer of Goods

The important features of the definition of 'consumer of goods' may be stated as follows:

1. **Buying goods for consideration:** There must be a contract of sale of goods between a seller and a buyer. The seller should be a 'business seller', *i.e.*, a trader or manufacturer, and the buyer should be 'consumer buyer', *i.e.*, who buys goods for consumption or private use. The buying of goods must be for consideration, which may be paid immediately or promised to be paid later—even in instalments. Thus, it includes credit sale and hire purchase transactions also. Consideration may be in terms of money or other goods and services.

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The meaning of the term 'goods' is to be construed according to the Sale of Goods Act. According to Section 2(7) of the Sale of Goods Act, 'goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.' Thus, goodwill, trademarks, copyrights, patent-rights, are all regarded as goods.

2. **User of goods with the approval of the buyer:** The term 'consumer' also includes any person who uses the goods with the permission of the buyer though he is himself not a buyer. When a person buys goods, they may be used by his family members, relatives and friends. The actual user of the goods may come across the defects in goods. Thus, the law treats rightful user of the goods as consumer.

   Illustration: *A* purchased a car. One of his family members *B* was using it from the date of purchase. *B* had a complaint regarding the car. *B* sued the seller. The seller pleaded that since *B* did not buy the car, he was not a consumer under the Act. The Delhi State Consumer Disputes Redressal Commission held that *B*, the complainant was using it with the approval of *A*, the buyer, and therefore, he was a consumer under the Act (*Dinesh Bhagat* vs *Bajaj Auto Ltd*.).

3. **Goods should not be purchased for resale or for any commercial purpose:** The term 'consumer' does not include a person who buys goods for 'resale' or for any 'commercial purpose'. The expression 'commercial propose' implies that the goods are bought to commercially exploit them with the object to earn profits. Thus, where a company purchases a computer system to facilitate its work, the said purchase is a purchase for 'commercial purpose' and the company is not a 'consumer' under the Act.

   Illustration: A charitable trust was running a diagnostic centre, where patients taking advantage of X-ray, CT scan, etc. were ordinarily required to pay for the same and only 10% of them being provided free service. It was held that the machines purchased by the 'Trust' for use in the diagnostic centre were meant for 'commercial purpose', and therefore the 'Trust' was not a consumer (*Kalpavraksha Charitable Trust* vs *Toshniwal Brothers* (*Bombay*) (*P*) *Ltd*.).

4. **Person buying goods for self-employment is a consumer:** When the goods are bought and used by the buyer himself, exclusively for the purpose of earning his livelihood, by means of self-employment, then such buyer/ user is also recognised as a consumer under the Act. Thus a person who purchases a taxi, or a sewing machine or a Photostat machine exclusively for the purpose of earning his livelihood by means of self-employment, will be a 'consumer'.

Illustration: *P*, an eye surgeon, purchased a machine from *R* for his private nursing home. The machine was found to be defective one. *P* sued *R* for damages. *R* contended that *P* was not a consumer under the Act as the machine was brought for commercial purposes. The National Commission rejected this contention and held that *P* is a medical practitioner, a professional working by way of self-employment by using his knowledge to earn his livelihood and therefore, he is a 'consumer' (*Rampion Pharmaceuticals* vs *Dr. Preetam Shah*).

II. Consumer of Services

The second category of 'consumer' is that of 'consumer of services'. A person is a 'consumer of service' if he satisfies the following criteria:

1. **Hiring of services for consideration:** There must be a transaction of hiring or availing of service for consideration. However, the payment of consideration need not necessarily be immediate. It may be paid later. If the service is provided without charging anything in return, the person availing the services is not a 'consumer'.
2. **Beneficiary of service is also a 'consumer':** A beneficiary of services, though not the hirer himself, is also regarded as a 'consumer' provided the beneficial use is made with the approval of the person who hired the service. Thus, a nominee under and insurance policy and an actual user of the subscriber's telephone have been held to be 'consumer'.

   Illustration: *R* takes his wife *S* to a doctor to get his wife treated for a fracture. The doctor charged ₹1200 for the treatment. Here *R* is a hirer of services of the doctor and *S* is beneficiary of the service. For the purpose of the Act, both *R* and *S* are 'consumers'.
3. **Service should not be availed for any commercial purpose:** The term 'consumer of service' does not include a person who avails service for any 'commercial purpose'. Thus, where a person hires the services of a goods carrier and starts plying it on hire as public carrier with the object to earn profits, the said hiring of services of a goods carrier is for 'commercial purpose' and the person is not a 'consumer' under the Act.

   Section 2 (1)(Q) defines the term 'service' as follows:

'Service' means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information. However, it does not include the rendering of any service free of charge or under a contract of personal service.

The expression 'contract of personal service' means contract to render service in a private capacity to an individual. For example, where a servant enters into a contract with a master for employment, it is a contract of personal service.

The rationale for excluding a 'contract of personal service' from the definition of 'service' is that the master can discontinue the service at any time according to his will, he need not approach Consumer Forum to complain about deficiency in service.

Check Your Progress

1. What does the term 'consumer' mean?
2. List the different types of consumers.
3. What do you understand by the term 'service'?

8.4 REDRESSAL OF COMPLAINTS

Let us now discuss the redressal mechanism of complaints.

8.4.1 Consumer Protection Councils

The Consumer Protection Councils are established at Center level, State level and District level. We have one Central Council, many State Councils and many District Councils. These Councils work towards the promotion and protection of the rights of the consumers. They give publicity to the matters concerning consumer interests, take steps towards furthering consumer education and protecting consumer from exploitation. They advise the Government in matters of policy formulation regarding protection of the consumer rights. The Government has notified, 'The Consumer Protection Rules, 1987' with a view to prescribe procedure in regard to the transaction of business by the Central Council and to prescribe the rules as to the composition of the Central Council. These rules also prescribe the terms and conditions of service of the members of the National Commission, procedure to be followed for conduct of business and for hearing of appeal by the National Commission.

A. Central Consumer Protection Council (Central Council)

Section 4 provides that:

(1) The Central Government shall, by notification, establish with effect from such date as it may specify in such notification, a council to be known as the Central Consumer Protection Council (hereinafter referred to as the Central Council).

(2) The Central Council shall consist of the following members, namely:

(*a*) The Minister-in-charge of Consumer Affairs in the Central Government, who shall be its Chairman, and

(*b*) Such number of other official or non-official members representing such interests as may be prescribed.

i. Constitution of Central Council

The constitution of Central Council has since been prescribed under Rule 3 of the Consumer Protection Rules, 1987. It provides that the Central Council shall consist of the following members, not exceeding 150, namely:

(*i*) The Minister-in-charge of Consumer Affairs in the Central Government who shall be the Chairman of the Central Council.

(*ii*) The Minister of State (where he is not holding independent charge) or Deputy Minister-in-charge of Consumer Affairs in the Central Government who shall be the Vice Chairman of the Central Council.

(*iii*) The Minister-in-charge of Consumer Affairs in States.

(*iv*) Eight Members of Parliament – Five from Lok Sabha and three from the Rajya Sabha.

(*v*) The Secretary of the National Commission for Scheduled Castes and Scheduled Tribes.

(*vi*) Representatives of the Central Government departments and autonomous organisations concerned with consumer interests – not exceeding twenty.

(*vii*) The Registrar, National Consumer Disputes Redressal Commission, New Delhi.

(*viii*) Representatives of the Consumer Organisations or consumers – not less than thirty-five.

(*ix*) Representatives of women – not less than ten.

(*x*) Representatives of farmers, trade and industries – not exceeding twenty.

(*xi*) Persons capable of representing consumer interests not specified above – not exceeding fifteen.

(*xii*) The Secretary-in-charge of Consumer Affairs in the Central Government shall be the member secretary of the Central Council.

It may thus be observed that members of the Council are selected from the various areas affecting consumers' interest, who are leading members of state-wide organisations representing segments of the consumer public, so as to establish a broadly based and representative Central Council.

a. **Term*:*** The term of the Council shall be three years.

b. **Vacancy*:*** Any member may, by writing under his hand to the Chairman of the Central Council, resign from the Council. The vacancies, so caused or otherwise, shall be filled from the same category by the Central Government and such person shall hold office so long as the member whose place he fills would have been entitled to hold office, if the vacancy had not occurred.

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ii. Procedure for meetings of the Central Council (Sec. 5).

The Central Council shall meet as and when necessary, but at least one meeting of the Council shall be held every year. It shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of business as may be prescribed.

Rule 4 of the Consumer Protection Rules, 1987 provides that the Central Council shall observe the following procedure in regard to the transaction of its business:

(1) The meeting of the Central Council shall be presided over by the Chairman. In the absence of the Chairman, the Vice-Chairman shall preside over the meeting of the Central Council. In the absence of the Chairman and the Vice-Chairman, the Central Council shall elect a member to preside over that meeting of the Council.

(2) Each meeting of the Central Council shall be called by giving not less than ten days from the date of issue, notice in writing to every member.

(3) Every notice of a meeting of the Central Council shall specify the place and the day and hour of the meeting and shall contain statement of business to be transacted thereat.

(4) No proceeding of the Central Council shall be invalid merely by reasons of existence of any vacancy in or any defect in the constitution of the Council.

(5) For the purpose of performing its functions, the Central Council may constitute from amongst its members, such working groups as it may deem necessary to perform the assigned functions. The findings of such working groups shall be placed before the Central Council for its consideration.

(6) The non-official members attending meeting of the Council or its Working Group shall be entitled to travelling and daily allowances at the specified rates.

(7) The resolution passed by the Central Council shall be recommendatory in nature.

iii. Objects of the Central Council (Sec. 6).

In fact the objects of the Central Council are the various rights of consumers recognised under the Act which are to be promoted and protected by the Council. Thus the Act (under Section 6) has enumerated some rights of consumers which need to be protected by the Council. These rights of consumers are:

(1) **Right to safety**: This right has been recognised by Section 6(a) as, 'the right to be protected against the marketing of goods and services which are hazardous to life and property'. The rationale behind this provision is to ensure physical safety of the consumers. The law seeks to ensure that those

responsible for bringing goods to the market, in particular, manufacturers, distributors, retailers and the like should ensure that the goods are safe for the users. In case of dangerous or risky goods, consumer should be informed of the risk involved in improper use of goods. Vital safety information should be conveyed to consumers.

Illustration: *M* bought an insecticide from *N*. *N* did not inform *M* that touching this insecticide with bare hands can create skin problem. *M*, while using the insecticide came in contact with it and suffered from skin problem consequently. Here *N* can be held liable under the Act.

(2) **Right to information:** Under Section 6(b), this right has been recognised as, 'the right to be informed about the quality, quantity, potency, purity, standard and price of goods or services, as the case may be, so as to protect the consumer against unfair trade practices'. Adequate information is very important in order to make a right choice of goods to be purchased. This right ensures that the consumer should be made aware of the quality, weight, contents and price of the product at the very pre-purchase stage. The fixing of ISI mark and Agmark enables the consumer to know about its quality. Under some other legislations, it is mandatory for the manufacturers and packers to provide information on the package to the consumers about the contents, weight, purity and potency of the product being sold. Consumers suffer much on the price front as the prices often printed or tagged in the product are misleading and no price control is there except with respect to essential commodities. Advertisements also often mislead the consumers.

(3) **Right to choose:** This right has been recognised by Section 6(c) as, 'the right to be assured, wherever possible, access to a variety of goods and services at competitive prices'. Fair and effective competition must be encouraged so as to provide consumers with maximum information about the wide variety of competing goods available in the market. Shoppers or buyers guide should be made available to the consumers by the Government or Business Organisations to protect this right of consumers.

(4) **Right to be heard:** This right is ensured by Section 6(d) as, 'the right to be heard and to be assured that consumers' interests will receive due consideration at appropriate forums.' The Consumer Protection Act, 1986 has well taken care of this right by providing three stages redressal machinery to the consumers, namely, District Forum, State Commission and National Commission. Every consumer has a right to file complaint and be heard in that context. Further, with a view to providing better protection of this right, various public and private sector undertakings have provided Consumer Ombudsman (Complaint cells) to provide redressal to consumer complaints outside the courts.

(5) **Right against exploitation:** This right is guaranteed under Section 6(e) of the Act as, 'the right to seek redressal against unfair trade practices or

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restrictive trade practices or unscrupulous exploitation of consumers.' Consumers are the most helpless lot in our country due to very many factors. When consumers are exploited, adequate remedy must be made available. The Act has thus ensured to prevent exploitation of consumers by invoking the jurisdiction of Consumer Forums in cases involving unfair trade practices and restrictive trade practices.

(6) **Right to education:** This right has been recognised under Section 6(f) of the Act as, 'the right to consumer education.' The right to consumer education is a right which ensures that consumers are informed about the practices prevalent in the market, their rights and the remedies available to them. Unless the consumers are aware of their rights and remedies, protection of their interest shall remain a myth. In this connection, the role of Consumer Protection Councils is very vital. The Central Council must ensure to educate the consumers about their rights and remedies under the Act throughout the country and the State Councils and the District Councils must ensure to educate about these rights to consumers within their territories. For spreading this education, media, school curriculum and cultural activities, *etc.* may be used as a medium.

B. State Consumer Protection Councils (State Councils)

The power to establish State Councils is with the States. Section 7 provides that:

(1) The state Government shall, by notification, establish with effect from such date as it may specify in such notification, a council to be known as the State Consumer protection Council (hereinafter referred to as the State Council).

(2) The State Council shall consist of the following members, namely:

(*a*) The Minister-in-charge of Consumer Affairs in the state Government who shall be its Chairman;

(*b*) Such number of other official or non-official members representing such interests as may be prescribed by the State Government;

(*c*) Such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.

(3) The State Council shall meet as and when necessary but not less than two meetings shall be held every year.

(4) The State Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

It may thus be observed that the state Government has been empowered to decide the number and qualifications of the members of State Council besides the members nominated by the Central Government. The State Government has been

further empowered to prescribe the procedure to be followed by the State Council in regard to the transaction of its business.

Objects of the State Council (Sec. 8): 'The objects of every State Council shall be to promote and protect within the State the rights of the consumers laid down in Clauses (*a*) to (*f*) of Section 6.' Thus, the objects of the State Councils are same as that of the Central Council discussed above.

C. District Consumer Protection Councils (District Councils)

Section 8-A and 8-B of the Consumer Protection Act added by the Amendment Act of 2002 deals with the establishment of the District Councils at district level. Section 8-A provides that:

(1) The State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification.

(2) The District Consumer Protection Council (hereinafter referred to as the District Council) shall consist of the following members, namely:

   (*a*) The Collector of the District (by whatever name called), who shall be its Chairman; and

   (*b*) Such number of other official and non-official members representing such interests as may be prescribed by the State Government.

(3) The District Council shall meet as and when necessary but not less than two meetings shall be held every year.

(4) The District Council shall meet at such time and place as the Chairman may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed by the State Government.

Objects of the District Council (Sec. 8-B): 'The objects of every District Council shall be to promote and protect within the district the rights of the consumers as laid down in clauses (*a*) to (*f*) of Section 6.' These clauses have already been discussed under the sub-heading: Objects of the Central Council.

8.4.2 Consumer Disputes Redressal Agencies

The Consumer Protection Act, 1986 provides for a three-tier remedial machinery for speedy redressal of consumer disputes. According to Section 9, there shall be established for the purposes of this Act, the following agencies, namely:

(1) Consumer Disputes Redressal Forum to be known as the 'District Forum'. It is to be established by the State Government in each district of the state by notification. The State Government may, if it deems fit, establish more than one district forum in a district.

(2) State Consumer Disputes Redressal Commission (SCDRC) to be known as 'State Commission'. This is also to be established by the State Government in the State by notification.

(3) National Consumer Disputes Redressal Commission (NCDRC) to be known as 'National Commission'. This is to be established by the Central Government by notification.

These Forums have not taken away the jurisdiction of the civil courts but have provided an alternative remedy. Their prime objective is to relieve the conventional courts of their burden which is ever increasing and delaying the disposal of suits due to technicalities. These agencies are quasi-judicial bodies. They are manned by qualified persons and have been vested with considerable powers. They are required to assign reasons for their conclusions. Obligation to give reasons not only introduces clarity but it also excludes, or at least minimises, the chances of arbitrariness.

8.4.3 District Forum

Let us discuss the various features of District Forum. These are:

A. Composition of the District Forum

Section 10 elaborates upon the composition of the District Forum. It provides that each District Forum shall consist of:

(*a*) A person who is, or has been, or is qualified to be a District Judge, who shall be its President;

(*b*) Two other members, one of whom shall be a woman, who shall have the following qualifications, namely:

- (*i*) Be not less than 35 years of age;
- (*ii*) Possess a bachelor's degree from a recognised university; and
- (*iii*) Be persons of ability, integrity and standing and have adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration.

B. Disqualifications

A person shall be disqualified for appointment as member if:

(*a*) He has been convicted and sentenced to imprisonment for an offence involving moral turpitude; or

(*b*) He is an undischarged insolvent; or

(*c*) He has been adjudged to be of unsound mind; or

(*d*) He has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government; or

(*e*) He has, in the opinion of the State Government , such financial or other interest as is likely to affect prejudicially the discharge by him of his functions as a member; or

(*f*) He has such other disqualifications as may be prescribed by the State Government.

C. Appointing authority [Sec. 10(1-A)].

Every appointment of the President and members of the District Forum shall be made by the State Government on the recommendations of a selection committee consisting of the following:

(*i*) President of the State Commission—Chairman.

(*ii*) Secretary, Law Department of the State—Member.

(*iii*) Secretary in-charge of the Department dealing with consumer affairs in the State—Member.

Where the President of the State Commission is, by reasons of absence or otherwise, unable to act as Chairman of the Selection Committee, the State Government may refer the matter to the Chief Justice of the High Court for nominating a sitting judge of that High Court to act as Chairman.

D. Term of office [Sec. 10(2)]

Every member of the District Forum shall hold office for a term of 5 years or up to the age of 65 years, whichever is earlier. However, he shall be eligible for re-appointment subject to similar conditions as stated here-in-before.

E. Terms and conditions of service [Sec. 10(3)]

The salary or honorarium and other allowances payable to, and the other terms and conditions of service of the members of the District Forum shall be such as may be prescribed by the State Government.

In terms of proviso to Section 10(3), the appointment of a member on whole-time basis shall be made by the State Government on the recommendation of the President of the State Commission taking into consideration such factors as may be prescribed including the work-load of the District Forum.

F. Jurisdiction of the District Forum

The term, jurisdiction may be defined as authority or legal power to hear and decide the cases. Thus, a court may adjudicate only those matters which fall under its jurisdiction. The question of jurisdiction has to be considered with reference to the value, place and the nature of subject-matter. For example, where *A* and *B* reside in Bombay and they have some dispute, their dispute may be subjected to the jurisdiction of the Bombay courts only. Courts of any other place cannot adjudicate the issue.

i. Pecuniary jurisdiction [Sec. 11(1)]: The District Forum shall have jurisdiction to entertain complaints where the value of goods or services and the compensation, if any, claimed does not exceed ₹20 lakh.

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In *Farook Haji Ismail* vs *Gavabhai Bhesania*, the Gujarat High Court held that the pecuniary jurisdiction depends upon the amount of the relief claimed and not upon the value of the subject-matter, nor upon the relief allowed by the Forum.

Thus, the District Forum entertains the cases where the value of claim is up to ₹20 lakhs. Where a claim exceeds this limit, the matter is beyond the jurisdiction of the Forum.

ii. Territorial jurisdiction [Sec. 11(2)]: A complaint shall be instituted in a District Forum within the local limits of whose jurisdiction:

(*a*) The opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business, or has a branch office or personally works for gain; or

(*b*) Any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually or voluntarily resides, or carries on business or has a branch office, or personally works for gain, provided the other parties not so residing or working agrees or the District Forum gives permission in this regard; or

(*c*) The cause of action, wholly or in part, arises.

It may be recalled that a limitation period has also been prescribed under Section 24-A. Accordingly, a complaint can only be lodged within two years from the date on which the cause of action has arisen.

G. Manner in Which Complaint Shall be Made (Sec. 12)

Section 12(1) lists the persons who can file a complaint. This has been explained earlier under the side-heading: 'Who can file a Complaint'. The expression, 'complaint' has also been explained earlier.

Section 12(2)(3)(4) elaborates the manner in which complaint shall be made. It provides that:

(1) Every complaint filed with a District Forum shall be accompanied with such amount of fee and payable in such manner as may be prescribed.

The fee for making complaints before District Forum and the manner in which the fee shall be payable have since been prescribed under Rule 9A of the Consumer Protection Rules, 1987. It provides that:

Every complaint filed with a District Forum shall be accompanied by a fee, as specified in the table given below, in the form of crossed Demand Draft drawn on nationalised bank or through a crossed Indian Postal Order drawn on in favour of the Registrar of the State Commission and payable at the respective place where the State Commission is situated. The concerned District Forum shall deposit the amount of fee so received in the State Government Receipt Account.

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Fee Schedule

Sl. No.	Value of goods or services and the compensation claimed	Amount of fee payable
(*i*)	Up to ₹1 lakh	100
(*ii*)	₹1 lakh and above but less than ₹5 lakh	200
(*iii*)	₹5 lakh and above but less than ₹10 lakh	400
(*iv*)	₹10 lakh and above but not exceeding ₹20 lakh	500

(2) On receipt of a complaint, the District Forum may, by order, admit the complaint or reject the same. However, a complaint shall not be rejected unless an opportunity of being heard has been given to the complainant. The admissibility of the complaint shall ordinarily be decided within 21 days from the date on which the complaint was received.

(3) Where a complaint is admitted, the District Forum shall follow the procedure prescribed in Section 13 (explained under the next heading).

(4) Once a complaint is admitted by the District Forum, it shall not be transferred to any other court or tribunal set up under any other law.

Note: The above provisions of Section 12 and the rules made thereunder regarding the fee payable for making complaints shall also be applicable to the disposal of disputes by the State Commission and National Commission as per Section 18 and Section 22 (1) respectively.

H. Procedure to be followed on Admission of a Complaint (Sec.13)

The procedure to be followed by the District Forum on admission of a complaint can be discussed under the following two heads:

1. Where laboratory test is required to determine the defects in goods.
2. Where no laboratory test is required to determine the defects in goods or the complaint relates to services.

1. Where laboratory test is required to determine the defects in goods: The procedure to be followed is as follows:

(*a*) The District Forum shall refer a copy of the admitted complaint, within 21 days from the date of its admission, to the opposite party directing him to give his version of the case within a period of 30 days which can be extended by a period up to 15 days.

(*b*) Where the opposite party, on receipt of the complaint referred to him, admits the allegation, the District Forum shall decide the matter on the basis of merits of the case and documents before it.

(*c*) Where the opposite party, on receipt of a complaint referred to him, denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District

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Forum, the District Forum would take the following steps to settle the dispute:

(*i*) The District Forum may require the complainant to deposit specified fee for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question.

(*ii*) The District Forum will obtain a sample of the goods from the complainant, seal it, authenticate it and refer the sample so sealed to the appropriate laboratory, for an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect and to report its findings thereon to the District Forum within a period of 45 days of the receipt of the reference or within such extended period as may be granted by the District Forum.

(*iii*) The District Forum will remit the fees to the appropriate laboratory to enable it to carry out required analysis or test.

(*iv*) Upon receiving the laboratory's report, its copy will be forwarded by the District Forum to the opposite party along with its own remarks.

(*v*) In the event of any party disputing the correctness of the findings, or the methods of analysis or test adopted by the appropriate laboratory, the District Forum shall require the objecting party to submit his objections in writing.

(*vi*) The District Forum will give a reasonable opportunity of being heard to the objecting party.

(*d*) The District Forum shall issue an appropriate order under Section 14 after hearing the parties.

2. Where no laboratory test is required to determine defects in goods or the complaint relates to services. In such a case the following procedure is followed:

(*a*) The District Forum shall refer a copy of the admitted complaint, within 21 days from the date of its admission, to the opposite party directing him to give his version of the case within a period of 30 days which can be extended by a period not exceeding 15 days.

(*b*) The opposite party on receipt of the complaint referred to him may:

(*i*) Admit the allegation, or

(*ii*) Deny or dispute the allegations contained in the complaint, or

(*iii*) Omit or fail to respond within the time given by the District Forum.

(*c*) (*i*) Where the opposite party admits the allegation, the District Forum shall decide the matter on the basis of the merits of the case.

(*ii*) Where the opposite party denies or disputes the allegations made in the complaint, the District Forum will proceed to settle the dispute on the basis of the evidence brought to its notice by both the parties.

(*iii*) Where the opposite party omits or fails to respond within the time given by the District Forum, the Forum will proceed to settle the dispute *ex-parte* on the basis of evidence brought to its notice by the complainant.

(*d*) The District Forum shall issue an appropriate order, under Section 14, after hearing the parties and taking into account available evidence.

(*e*) Where the complainant fails to appear on the date of hearing before the District Forum, the Forum may either dismiss the complaint for default or decide it on merits.

I. Time limit for disposal of complaint [Sec. 13(3A)]

Every complaint shall be heard as expeditiously as possible and endeavour shall be made to decide the complaint within a period of 3 months from the date of receipt of notice by opposite party where the complaint does not require analysis or testing of commodities and within 5 months if it requires analysis or testing of commodities. In the event of a complaint being disposed of after the period specified above, the District Forum shall record in writing the reasons for the same.

J. Power to pass interim order [Sec 13(3B)]

Where during the pendency of any proceeding before the District Forum, it appears to it necessary, it may pass such interim order as is just and proper in the facts and circumstances of the case.

Note: The above provisions of Section 13 regarding procedure to be followed by the District Forum on admission of a complaint shall also be applicable to the disposal of disputes by the State Commission and National Commission as per Section 18 and Section 22(1) respectively.

8.4.4 State Commission

After the District Forum, State Commission is next in the hierarchy of Consumer Disputes Redressal Agencies under the Act. Let us discuss some of the features of State Commission. These are:

A. Composition of the State Commission

Section 16 contains the provisions regarding the composition of the State Commission. These are:

(1) Each State Commission shall consist of:

(*a*) A person who is or has been a judge of a High Court, appointed by the State Government, who shall be its President. But no such appointment shall be made except after consultation with the Chief Justice of the High Court;

(*b*) At least two other members or such higher number of members as may be prescribed, one of whom shall be a woman, who shall have the following qualifications, namely:

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(*i*) Be not less than 35 years of age;

(*ii*) Possess a bachelor's degree from a recognised university; and

(*iii*) Be persons of ability, integrity and standing, and have adequate knowledge and experience of at least 10 years in dealing with problems relating to economics, law, commerce, accountancy, industry, public affairs or administration:

Provided that not more than 50 per cent of the members shall be from amongst persons having a judicial background.

Explanation: For the purpose of this clause, the expression 'persons having judicial background' shall mean persons having knowledge and experience for at least a period of 10 years as a presiding officer at the district level court or any tribunal at equivalent level.

B. Disqualifications

A person shall be disqualified for appointment as member if:

(*a*) He has been convicted and sentenced to imprisonment for an offence involving moral turpitude; or

(*b*) He is an undischarged insolvent; or

(*c*) He has been adjudged to be of unsound mind; or

(*d*) He has been removed or dismissed from the service of the Government or a body corporate owned or controlled by the Government; or

(*e*) He has, in the opinion of the State Government, such financial or other interest, as is likely to affect prejudicially the discharge by him of his functions as a member; or

(*f*) He has such other disqualifications as may be prescribed by the state Government.

C. Appointing authority [Sec. 16(1-A)]

The provisions as to the process of appointment of the President and members of the state Commission are similar to those discussed in the context of appointment of the President and members of the District Forum. Refer preceding centre heading 'District Forum' for details.

D. Benches [Sec. 16(1-B)]

The jurisdiction, powers and authority of the State Commission may be exercised by Benches thereof. A Bench may be constituted by the President with the one or more members as the President may deem fit.

If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority. But if the members are equally divided, they shall state the point or points on which they differ, and make a reference

to the President who shall either hear the point(s) himself or refer the case for hearing on such point(s) by one or more or the other members and such point(s) shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it.

E. Terms and conditions of service [Sec. 16(2)]

The salary or honorarium and other allowances payable to, and the other terms and conditions of service of the members of the State Commission shall be such as may be prescribed by the State Government. Provided that the appointment of a member on whole-time basis shall be made by the State Government on the recommendation of the President of the State Commission taking into consideration such factors as may be prescribed including the work load of the State Commission.

F. Term of office [Sec. 16(3)]

Every member of the State Commission shall hold office for a term of 5 years or up to the age of 67 years, whichever is earlier. However, he shall be eligible for re-appointment subject to similar conditions as stated here-in-before. Further, a person appointed as President of the State Commission shall also be eligible for re-appointment.

G. Jurisdiction of the State Commission

i. **Pecuniary jurisdiction** [Sec. 17(1)]: The State Commission shall have jurisdiction to entertain complaints where the value of goods or services and compensation, if any, claimed exceeds ₹20 lakh but does not exceed ₹1 crore.

   It may be recalled that the decisive factor regarding pecuniary jurisdiction is the value of claim. Thus, the State Commission entertains cases where the value of claim is more than ₹20 lakh but is up to ₹1 crore.

ii. **Territorial jurisdiction** [Sec. 17(2)]: A suit can be instituted in the State Commission within the local limits of whose jurisdiction:

   (*a*) The opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides or carries on business or has a branch office or personally works for gain; or

   (*b*) Any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office, or personally works for gain, provided the other parties not so residing or working agrees or the State Commission gives permission in this regard; or

   (*c*) The cause of action, wholly or in part, arises.

iii. **Appellate jurisdiction** [Sec. 17(1)(a)(ii)]: The State Commission has power to entertain the appeals against the orders of any District Forum within the

State within 30 days from the date of service of the order to the appellant.

iv. Revisional jurisdiction [Sec. 17(1)(b)]: The State Commission has power to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State, where State Commission is of the view that the District Forum:

(*i*) Has exercised a jurisdiction/power which it was not entitled to, or

(*ii*) Has failed to exercise a power which was vested in it, or

(*iii*) Has exercised its authority illegally or with material irregularity.

Such revisional power may be exercised by the State Commission either on its own or on the application of a party.

H. Procedure to be followed by the State Commission

As observed earlier, the provisions of Section 13 regarding procedure to be followed by the District Forum, which have already been discussed, shall be applicable also to the disposal of disputes by the State Commission as per Section 18.

8.4.5 National Commission

The National Commission is the top most layer in the three-level hierarchy of the Consumer Disputes Redressal Agencies. Let us discuss some of the features of National Commission. These are:

A. Composition of the National Commission

Section 20 elaborates upon the composition of National Commission. It provides that:

(*i*) The National Commission shall consist of:

(*a*) A person who is or has been a judge of the Supreme Court, to be appointed by the Central Government, who shall be its President. But no such appointment shall be made except after consultation with the Chief Justice of India.

(*b*) At least four other members or such higher number of members as may be prescribed, and one of them shall be a woman.

The provisions as to the qualifications and disqualifications of the members of National Commission are similar to those discussed under the preceding centre heading: 'State Commission'.

B. Appointing authority

The appointment of members of the National Commission is made by the Central Government on the recommendation of a Selection Committee consisting of the following:

(*i*) A person who is a judge of the Supreme Court, to be nominated by the Chief Justice of India – Chairman.

(*ii*) The secretary in the Department of Legal Affairs in the Government of India – Member.

(*iii*) Secretary of the Department dealing with the consumer affairs in the Government of India – Member.

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C. Benches [Sec. 20(1A)]

The jurisdiction, powers and authority of the National Commission may be exercised by Benches thereof. A Bench may be constituted by the President with one or more members as the President may deem fit.

D. Term of office [Sec. 20(3)]

Every member of the National Commission shall hold office for a term of 5 years or up to the age of 70 years, whichever is earlier. However, he shall be eligible for re-appointment subject to similar conditions as stated here-in-before. Further, a person appointed as President of the National Commission shall also be eligible for re-appointment.

E. Jurisdiction of National Commission

i. Pecuniary jurisdiction [Sec. 21(a)(i)]: The National Commission shall have jurisdiction to entertain complaints where the value of goods or services and compensation, if any, claimed exceeds ₹1 crore.

Since National Commission is the highest level of the Consumer Forum, it entertains all the cases where the value of claim is more than ₹1 crore.

ii. Territorial jurisdiction: The territorial jurisdiction of the National Commission is the whole of India except the State of Jammu and Kashmir.

iii. Appellate jurisdiction [Sec. 21(a)(ii)]: The National Commission has jurisdiction to entertain appeals against the order of any State Commission, within 30 days from the date of service of the order to the appellant.

iv. Revisional jurisdiction [Sec. 21(b)]: The National Commission has power to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission, where it is of the view that the State Commission:

(*i*) Has exercised a jurisdiction/power not vested in it by law, or

(*ii*) Has failed to exercise a power which was vested in it, or

(*iii*) Has exercised its authority illegally or with material irregularity.

Such revisional power may be exercised by the National Commission either on its own or on the petition of a party.

F. Procedure to be followed by the National Commission

Rule 14 of the Consumer Protection Rules, 1987, as amended by the Consumer Protection (Amendment) Rules, 2004, lays down the procedure, which is as follows:

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(1) A complaint containing the following particulars shall be presented by the complainant in person or by his agent to the National Commission or be sent by registered post:

(*a*) The name, description and address of the complainant;

(*b*) The name, description and address of the opposite party or parties, as the case may be, so far as they can be ascertained;

(*c*) The facts relating to complaint and when and where it arose;

(*d*) Documents in support of the allegations contained in the complaint;

(*e*) the relief which complainant claims.

(2) Every complaint filed with the National Commission shall be accompanied by the relevant fee as is specified in Rule 9A of the Consumer Protection Rules, 1987. For details refer to the Side Heading: 'Manner in which complaint shall be made to the District Forum' (given before).

(3) The National Commission shall, in disposal of any complaint before it, as far as possible, follow the procedure as laid down in Section 13 in relation to the complaints received by the District Forum (discussed already under the Side Heading: 'Procedure to be followed on Admission of a Complaint'). Section 22(1) also provides to the same effect.

(4) On the date of hearing, it shall be obligatory on the parties or their agents to appear before the National Commission. Where the complainant or his agent fails to appear, the National Commission may either dismiss the complaint for default or decide it on merits. Where the opposite party or its agent fails to appear on the date of hearing, the National Commission may decide the complaint *ex-parte.*

(5) The complaint shall be decided, as far as possible, within a period of three months from the date of notice received by the opposite party where complaint does not require analysis or testing of commodities and within five months if it requires analysis or testing of commodities. In the event of a complaint being disposed of after the period specified above, the National Commission shall record in writing the reasons for the delay.

(6) After the proceedings, the National Commission shall issue an appropriate order under Section 14. It shall also have the power to direct that any order passed by it, where no appeal has been preferred under Section 23, be published in the Official Gazette or through any other media.

8.4.6 Powers of the Consumer Forums

For the purpose of adjudicating a consumer dispute, Section 13(4) has vested the Consumer Forums, namely, District Forum, State Commission and National Commission, with certain powers of a civil court. Apart from these powers, the Central Government has provided some additional powers to them under Rule 10 of the Consumer Protection Rules, 1987. Finally, Section 14(1) has given them

the power to issue orders. Here, we will also discuss some of special/additional/ appellate powers of the consumer forums. These are:

A. Powers similar to those of civil court [Sec. 13(4)]

The Consumer Forums are vested with the powers of a civil court, while trying a suit, in respect of the following matters:

(*i*) Summoning and enforcing the attendance of any defendant or witness and examining the witness on oath;

(*ii*) Discovery and production of any document or other material object producible as evidence;

(*iii*) Receiving of evidence on affidavits;

(*iv*) Requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source;

(*v*) Issuing of any commission for the examination of any witness; and

(*vi*) Any other matter which may be prescribed.

Sub-Section(5) of Section 13 further provides that every proceeding before the District Forum, the State Commission or the National Commission, as the case may be, shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code (punishment for false evidence and intentional insult or interruption to public servant sitting in judicial proceeding) and the Forums shall be deemed to be civil courts for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 (prosecution for contempt and provisions as to offences affecting the administration of justice).

B. Additional powers of the consumer forums (Rule 10 of the Consumer Protection Rules, 1987)

The National Commission, the State Commission and the District Forum have the following additional powers:

(*a*) Requiring production of any books, accounts, documents, or commodities from any person and getting them examined by an officer specified in this behalf.

(*b*) Obtaining information required for the purpose of the proceedings from any person.

(*c*) Authorising any officer to enter and search any premises and seize from premises such books, papers, documents and commodities as are required for the purpose of proceedings under the Act.

(*d*) On examination of such seized documents or commodities, ordering the retention thereof or returning them to the party concerned.

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C. Power to issue order [Sec. 14(1)]

If, after the proceeding conducted under Section 13 (explained earlier), the National Commission, the State Commission or the District Forum, as the case may be, is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services are proved, it shall issue an order to the opposite party directing him to do one or more of the following things:

(*a*) To remove the defect pointed out by the appropriate laboratory from the goods in question;

(*b*) To replace the goods with new goods of similar description which shall be free from any defect;

(*c*) To return to the complainant the price, or, as the case may be, the charges paid by the complainant;

(*d*) To pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party. The Consumer Protection (Amendment) Act, 2002 has further empowered these Forums to grant punitive damages in such circumstances as it deems fit;

(*e*) To remove the defects in goods or deficiencies in the services in question;

(*f*) To discontinue the unfair trade practice or restrictive trade practice or not to repeat it;

(*g*) Not to offer the hazardous goods for sale;

(*h*) To withdraw the hazardous goods from being offered for sale;

(*i*) To cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature;

(*j*) To pay such sum as may be determined by it if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently, provided that the minimum amount of sum so payable shall not be less than 5% of the value of such defective goods sold or service provided, as the case may be, to such consumers, and the amount so obtained shall be credited in favour of such person and utilised in such manner as may be prescribed;

(*k*) To issue corrective advertisement to neutralize the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;

(*l*) To provide for adequate costs to parties.

Sub-Section (2) of Section 14 provides that every proceeding is required to be conducted by the President of the Forum and at least, one member thereof sitting together. Where the member, for any reason, is unable to conduct the

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proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member.

Sub-Section (2A) of Section 14 provides that every order made under this Section shall be signed by the President and the member or members who conducted the proceedings.

D. Special Powers of State Commission

Through Consumer Protection (Amendment) Act, 2002 two new provisions have been added for conferring additional powers on the State Commission in the interest of justice. These provisions are as follows:

1. **Transfer of cases** (Sec. 17A): On the application of the complainant or of its own motion, the State Commission may, at any stage of proceeding, transfer any complaint pending before the District Forum to another District Forum within the state if the interest of justice so requires.

   It may thus be noticed that the State Commission has been given the power to transfer cases from one District Forum to another, that too at any stage of proceeding. The transfer of case can be ordered either on the application of the complainant or on its own motion. However, the defendant cannot move for transfer of case.
2. **Circuit benches** [Sec. 17B]: The State Commission shall ordinarily function in the State Capital but may perform its functions at such other place as the State Government may, in consultation with the State Commission, notify in the Official Gazette from time to time.

E. Special Powers of National Commission

The National Commission too has been conferred additional powers by the Consumer Protection (Amendment) Act, 2002 which are as follows:

1. **Power to set aside ex-parte orders** (Sec. 22A): Where an order is passed by the National Commission *ex-parte* against the opposite party or a complainant, as the case may be, the aggrieved party may apply to the Commission to set aside the said order in the interest of justice.

   It may be observed that the insertion of this new Section will obviously lessen the number of appeals from going to the Supreme Court from the orders of the National Commission.
2. **Transfer of cases** (Sec. 22B): On the application of the complainant or on its own motion, the National Commission may, at any stage of proceeding, in the interest of justice, transfer any complaint pending before the District Forum of one State to a District Forum of another State or before one State Commission to another State Commission.
3. **Circuit benches** (Sec. 22C): The National Commission shall ordinarily function at New Delhi and perform its functions at such other place as the

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Central Government may, in consultation with National Commission, notify in the Official Gazette, from time to time.

4. **Power to make regulations** (Sec. 30A): The National Commission may, with the previous approval of the Central Government, by notification, make regulations not inconsistent with this Act to provide for all matters for which provision is necessary or expedient for the purpose of giving effect to the provisions of this Act.

In particular, such regulations may make provisions for the cost of adjournment of any proceeding before the District Forum, the State Commission or the National Commission, as the case may be, which a party may be ordered to pay.

F. Enforcement of Orders of the Consumer Forums (Sec. 25)

Regarding the enforcement of orders of the District Forum, State Commission or the National Commission, Section 25 provides as follows:

(1) Where an interim order made under this Act is not complied with, the District Forum or the State Commission or the National Commission, as the case may be, may order the property of the person not complying with such order to be attached.

(2) No attachment made under sub-section (1) (stated above) shall remain in force for more than 3 months at the end of which, if the non-compliance continues, the property attached may be sold and out of the proceeds thereof, the District Forum or the State Commission or the National Commission may award such damages as it thinks fit to the complainant and shall pay the balance, if any, to the party entitled thereto.

(3) Where any amount is due from any person under an order made by a District Forum, State Commission or the National Commission, as the case may be, the person entitled to the amount may make an application to the concerned Forum and such Forum may issue a certificate for the said amount to the Collector of the District and the Collector shall proceed to recover the amount in the same manner as arrears of land revenue.

G. Appeals against Orders of the Forums

1. **Appellate power of the State Commission** (Sec. 15): Any person aggrieved by an order made by the District Forum may prefer an appeal against such order to the State Commission within a period of 30 days from the date of the order or within such extended time as the Commission may allow if it is satisfied that there was sufficient cause for not filing it within that period. However, no appeal by a person, who is required to pay any amount in terms of an order of the District Forum, shall be entertained unless the appellant has deposited fifty per cent of that amount or ₹25,000, whichever is less.

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It is worth noting here that the High Court is not a statutory appellate authority under the provisions of the Consumer Protection Act, 1986.

2. **Appellate power of the National Commission** (Sec. 19): Any person aggrieved by an order made by the State Commission may prefer an appeal against such order to the National Commission within a period of 30 days from the date of the order. The National Commission may, however, entertain an appeal after the expiry of the said period of 30 days if it is satisfied that there was sufficient cause for not filing it within that period. But no appeal by a person, who is required to pay any amount in terms of an order of the State Commission, shall be entertained unless the appellant has deposited fifty per cent of that amount or ₹ 35,000, whichever is less.

   Hearing of appeal (Sec. 19A): An appeal filed before the State Commission or the National Commission shall be heard as expeditiously as possible and an endeavour shall be made to finally dispose of the appeal within a period of 90 days from the date of its admission.

3. **Appeal to the Supreme Court** (Sec. 23): Any person aggrieved by an order made by the National Commission may prefer an appeal against such order to the Supreme Court within a period of 30 days from the date of the order or within such time as the Supreme Court allows. However, no appeal by a person, who is required to pay any amount in terms of an order of the National Commission, shall be entertained unless the appellant has deposited fifty per cent of that amount or ₹50,000, whichever is less.

H. Administrative Control

Section 24 B gives power to the National Commission to exercise administrative control over all the State Commissions. It also empowers the State Commissions to exercise administrative control over all the District Forums within their respective jurisdiction.

Vacancies or Defects in Appointment not to Invalidate Orders (Sec. 29A): No act or proceeding of the District Forum, the State Commission or the National Commission shall be invalid by reason only of the existence of any vacancy amongst its members or any defect in the constitution thereof.

I. Dismissal of Frivolous or Vexatious Complaints (Sec. 26)

Where a complaint instituted before the District Forum, the State Commission or, as the case may be, the National Commission, is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, dismiss the complaint and make an order that the complainant shall pay to the opposite party such cost, not exceeding ₹10,000, as may be specified in the order.

J. Penalties

Regarding the penalties, Section 27 provides as follows:

(1) Where a trader or a person against whom a complaint is made or the complainant fails or omits to comply with any order made by the District Forum, the State Commission or the National Commission, as the case may be, such trader or person or complainant shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to three years, or with fine ranging between ₹2,000 and ₹10,000, or with both.

(2) The District Forum or the State Commission or the National Commission, as the case may be, shall have the power of a Judicial Magistrate of the First Class for the trial of offences under this Act, and on such conferment of powers, they shall be deemed to be Judicial Magistrate of the First Class for the purpose of the Code of Criminal Procedure, 1973.

(3) All offences under this Act may be tried summarily by the District Forum or the State Commission or the National Commission, as the case may be.

Check Your Progress

4. What is the purpose of 'The Consumer Protection Rules, 1987'?
5. Who are the members of the Central Council?
6. List the rights of consumers.
7. Which Sections deal with the establishment of the District Councils at district level?

8.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The term 'Consumer' means:
   (i) Any person who buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment, and includes any person who uses such goods with the approval of the buyer. It does not include a person who buys goods for resale or for any commercial purpose; or
   (ii) Any person who hires or avails any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment, and includes any person who is a beneficiary of such services with the approval of the hirer. It does not include a person who avails of such services for any commercial purpose.

2. Consumer is of two types: Consumer of goods and Consumer of services.
3. 'Service' means service of any description which is made available to potential users and includes, but is not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information. However, it does not include the rendering of any service free of charge or under a contract of personal service.
4. The Government has notified, 'The Consumer Protection Rules, 1987' with a view to prescribe procedure in regard to the transaction of business by the Central Council and to prescribe the rules as to the composition of the Central Council. These rules also prescribe the terms and conditions of service of the members of the National Commission, procedure to be followed for conduct of business and for hearing of appeal by the National Commission.
5. The Central Council consists of (i) the Minister-in-charge of Consumer Affairs in the Central Government, who shall be its Chairman, and (ii) such number of other official or non-official members representing such interests as may be prescribed.
6. The rights of the consumers are (i) Right to safety (ii) Right to information (iii) Right to choose (iv) Right to be heard (v) Right against exploitation and (vi) Right to education.
7. Section 8-A and 8-B of the Consumer Protection Act added by the Amendment Act of 2002 deals with the establishment of the District Councils at district level. Section 8-A provides that the State Government shall establish for every district, by notification, a council to be known as the District Consumer Protection Council with effect from such date as it may specify in such notification.

8.6 SUMMARY

- The term 'consumer' includes any person who uses the goods with the permission of the buyer though he is himself not a buyer. When a person buys goods, they may be used by his family members, relatives and friends. The actual user of the goods may come across the defects in goods. Thus, the law treats rightful user of the goods as consumer.
- The Consumer Protection Councils are established at Center level, State level and District level. We have one Central Council, many State Councils and many District Councils. These Councils work towards the promotion and protection of the rights of the consumers.

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- The objects of the Central Council are the various rights of consumers recognised under the Act which are to be promoted and protected by the Council.
- The state Government has been empowered to decide the number and qualifications of the members of State Council besides the members nominated by the Central Government. The State Government has been further empowered to prescribe the procedure to be followed by the State Council in regard to the transaction of its business.
- The Consumer Protection Act, 1986 provides for a three-tier remedial machinery for speedy redressal of consumer disputes.
- Where the President of the State Commission is, by reasons of absence or otherwise, unable to act as Chairman of the Selection Committee, the State Government may refer the matter to the Chief Justice of the High Court for nominating a sitting judge of that High Court to act as Chairman.
- The fee for making complaints before District Forum and the manner in which the fee shall be payable have since been prescribed under Rule 9A of the Consumer Protection Rules, 1987.
- The State Commission shall have jurisdiction to entertain complaints where the value of goods or services and compensation, if any, claimed exceeds ₹20 lakh but does not exceed ₹1 crore.
- The State Commission has power to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Forum within the State.
- Every complaint filed with the National Commission shall be accompanied by the relevant fee as is specified in Rule 9A of the Consumer Protection Rules, 1987.
- Sub-Section(5) of Section 13 further provides that every proceeding before the District Forum, the State Commission or the National Commission, as the case may be, shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 of the Indian Penal Code.
- Any person aggrieved by an order made by the State Commission may prefer an appeal against such order to the National Commission within a period of 30 days from the date of the order.
- Where a trader or a person against whom a complaint is made or the complainant fails or omits to comply with any order made by the District Forum, the State Commission or the National Commission, as the case may be, such trader or person or complainant shall be punishable with imprisonment for a term which shall not be less than one month but which may extend to three years, or with fine ranging between ₹2,000 and ₹10,000, or with both.

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8.7 KEY WORDS

- **Consumer:** Any person who purchases goods and services for personal use is known as a consumer.
- **Complaint:** Complaint means a formal allegation against a party.
- **Defect:** It refers to frailty or shortcoming that prevents an item from being complete, desirable, effective, safe, or of merit, or makes it to malfunction or fail in its purpose.

8.8 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. Write a short note on the objectives of the Consumer Protection Act, 1986.
2. Write in brief about consumer of services.
3. Write a short note on the jurisdiction of District Forums.
4. Write in brief about the terms and conditions of service of the members of the State Commission
5. Write a short note on 'Special Powers' of National Commission as a consumer redressal agency.

Long-Answer Questions

1. Discuss the impact of the Consumer Protection Act, 1986 among consumers.
2. Analyse the various rights of consumers as enunciated by the Consumer Protection Act, 1986.
3. Discuss the main purpose behind the establishment of Consumer Protection Councils in India.
4. Discuss the procedure to be adopted by the District Forum on admission of a complaint.
5. Discuss the powers of the National Commission as a Consumer Disputes Redressal Agency.

8.9 FURTHER READINGS

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BLOCK - III
IPR & IT

UNIT 9 COMPETITION ACT, 2002

Structure

9.0 INTRODUCTION

The regulation of competition is a relatively new phenomenon in India. The earliest known attempt to regulate competition can be found in the Monopolistic and Restrictive Trade Practices (MRTP) Act, 1969. The Competition Act 2002, enacted in 2003, following the recommendation of the High Level Committee on Competition Policy and Law, is a landmark legislation that aims at promoting competition through prohibition of anti-competitive practices, abuse of dominance and regulation of combinations beyond a certain sizes. Certain amendments to the Competition Act were effected in 2007 and 2009. This Act, which extends to the whole of India except the State of Jammu and Kashmir, deals mainly with anti-competitive agreements, combinations and abuse of dominance and it provides for the establishment of a Competition Commission to control these. Competition Commission of India (CCI) Rules came into existence on 1 March 2009.

In this unit, you will learn about the various provisions of the Competition Act, including the provisions relating to offences and penalties under it.

9.1 OBJECTIVES

After going through this unit, you will be able to:

- Understand the meaning and scope of the Competition Act,2002
- Discuss the salient features of the Competition Act,2002
- Explain the offences and penalties under the Competition Act,2002

9.2 COMPETITION ACT, 2002: MEANING, SCOPE AND SALIENT FEATURES

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The common law doctrine of 'restraint of trade' has played a crucial role in the development of modern competition law. The essence of this doctrine is that it is contrary to public policy to enforce contracts that are in the nature of unreasonable restraints of trade. What is unreasonable was to be determined by considering whether the restraint was so large as to interfere with the interests of the general public. In the US, the common law doctrine of restraint of trade and the rule of reason approach to interpret their Sherman Act are the guiding force to deal anti-competitive practices. This approach has the effect of the restraint *between the parties*. Where the EU does also apply the common law doctrine of restraint of trade but that have the effect *on the market*.

9.2.1 Meaning and Scope

According to the introductory paragraph of the Act, it is an Act to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India.

9.2.2 Salient Features

The Competition Act, 2002 extends to the whole of India except the State of Jammu and Kashmir.

The main provisions of the Act pertain to prohibition of anti-competitive agreements; prevention of abuse of dominant position and regulation of combinations. In competition law, restraints have been broadly categorized into horizontal and vertical. Horizontal agreements are agreements between firms which operate at the same market level. Vertical agreements are between firms that are in some supply relationship. Horizontal agreements are almost always of concern to competition authorities, as these agreements tend to increase the chances of monopoly. Doubts have been raised on the benefits or harms to competition by regulating the vertical agreements in India. Though the India Competition Act does not use the words horizontal or vertical agreements, it treats certain kinds of horizontal agreements more severely, by presuming them to have adverse effects on competition. According to Section 3(3), agreements between parties (including cartels) that: (1) directly or indirectly determine purchase or sales prices; (2) limit or control production, supply, markets, technical development, investment or the provision of services; (3) share the market or source of production or provision of services by way of allocation of the geographical area of the market, type of goods or services, or number of customers in the market or any other similar way; and (4) directly or indirectly result in bid rigging or collusive bidding are 'presumed to have appreciable adverse effects on competition.'

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Section 3(4) of the Act deals vertical agreements. It lists, in particular, five types of vertical agreements - tying, exclusive supply, exclusive distribution, refusal to deal, and resale price maintenance, which would be in contravention of Section 3(1), only if they cause or are likely to cause appreciable adverse effects on competition in India.

US Courts relied on rule of reason which requires the initial burden lies on the plaintiff to show that the agreement in question is anticompetitive, on the other hand the EU applies the test for adverse effects. Presently, the Indian law borrowed the rule of reason approach of the US in determination of anti-competiveness of the agreement.

The Act also provides for the establishment of a Competition Commission to take care of these provisions and to protect the interests of consumers.

Abuse of dominant position

1. No enterprise shall abuse its dominant position.
2. There shall be an abuse of dominant position under sub-section (1), if an enterprise,-
    a. directly or indirectly, imposes unfair or discriminatory-
        i. condition in purchase or sale of goods or service; or
        ii. price in purchase or sale (including predatory price) of goods or service.

    Explanation: For the purposes of this clause, the unfair or discriminatory condition in purchase or sale of goods or service referred to in sub-clause (i) and unfair or discriminatory price in purchase or sale of goods (including predatory price) or service referred to in sub-clause (ii) shall not include such discriminatory condition or price which may be adopted to meet the competition; or
    b. limits or restricts-
        i. production of goods or provision of services or market there for; or
        ii. technical or scientific development relating to goods or services to the prejudice of consumers; or
    c. indulges in practice or practices resulting in denial of market access; or
    d. makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or
    e. uses its dominant position in one relevant market to enter into, or protect, other relevant market. Explanation.-For the purposes of this section, the expression-

f. "dominant position" means a position of strength, enjoyed by an enterprise, in the relevant market, in India, which enables it to-
   i. operate independently of competitive forces prevailing in the relevant market; or
   ii. affect its competitors or consumers or the relevant market in its favour;
g. "predatory price" means the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors. Regulation of combinations

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Competition Commission and Competition Appellate Tribunal

The Competition Act provides that there shall be established by the Central Government a Commission to be called the Competition Commission of India, consisting of a Chairperson and not less than two and not more than six other members. The Commission shall be an expert body which would function as a market regulator for preventing and regulating anti-competitive practices in the country in accordance with the Act and it would also have advisory and advocacy functions in its role as a regulator.

Regulation of Combinations

The Act provides for regulation of combination through mergers and acquisitions which causes or is likely to cause an appreciable effect on competition.

Power to exempt

The Central Government is empowered to exempt from the application of this Act, or any provision thereof, and for such period as it may specify:

(a) any class of enterprises if such exemption is necessary in the interest of security of the State or public interest;

(b) any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries;

(c) any enterprise which performs a sovereign function on behalf of the Central Government or a State Government, provided that in case an enterprise is engaged in any activity including the activity relatable to the sovereign functions of the Government, the Central Government may grant exemption only in respect of activity relatable to the sovereign functions.

Competition Law Review Committee

In pursuance of its objective of ensuring that Legislation is in sync with the needs of strong economic fundamentals, in 2018, the Government constituted a nine-member Competition Law Review Committee to review the Competition Act.

The Competition Act was passed in the year 2002 and the Competition Commission of India was set up in pursuance of the same. The Commission started functioning in right earnest from 2009 and has contributed immensely towards the development of competition and fair play practices in the Indian market. During the past nine years the size of the Indian Economy has grown immensely and India is today amongst the top five economies in the World and poised to forge ahead further. In this context, it is essential that Competition Law is strengthened, and re-calibrated to promote best practices which result in the citizens of this country achieving their aspirations and value for money.

The Terms of References of the Committee are as follows:

i. To review the Competition Act/ Rules/ Regulations, in view of changing business environment and bring necessary changes, if required;

ii. To look into international best practices in the competition fields, especially anti-trust laws, merger guidelines and handling cross border competition issues;

iii. To study other regulatory regimes/ institutional mechanisms/ government policies which overlap with the Competition Act;

iv. Any other matters related to competition issue and considered necessary by the Committee.

Check Your Progress

1. What is the objective of the Competition Act, 2002?
2. What is the provision regarding the constitution of the Competition Commission of India?

9.3 OFFENCES AND PENALTIES UNDER THE ACT

Chapter VI of the Competition Act provides for the provisions for various offences under the Act. Important ones are as follows:

Contravention of orders of Commission

- Without prejudice to the provisions of this Act, if any person contravenes, without any reasonable ground, any order of the Commission, or any condition or restriction subject to which any approval, sanction direction or exemption in relation to any matter has been accorded, given, made or granted under this Act or fails to pay the penalty imposed under this Act, he shall be liable to be detained in civil prison for a term which may extend to one year, unless in the meantime the Commission directs his release and he shall also be liable to a penalty not exceeding rupees ten lakhs.

- The Commission may, while making an order under this Act, issue such directions to any person or authority, not inconsistent with this Act, as it thinks necessary or desirable, for the proper implementation or execution of the order, and any person who commits breach of, or fails to comply with, any obligation imposed on him under such direction, may be ordered by the Commission to be detained in civil prison for a term not exceeding one year.

Penalty for failure to comply with directions of Commission and Director-General

- If any person fails to comply with a direction given by-
  a. the Commission under sub-section (5) of section 36; or
  b. the Director General while exercising powers referred to in sub-section (2) of section 41, the Commission shall impose on such person a penalty of rupees one lakh for each day during which such failure continues.

Penalty for making false statement or omission to furnish material information

- If any person, being a party to a combination,-
  a. makes a statement which is false in any material particular, or knowing it to be false; or
  b. omits to state any material particular knowing it to be material, such person shall be liable to a penalty which shall not be less than rupees fifty lakhs but which may extend to rupees one crore, as may be determined by the Commission.

Penalty for offences in relation to furnishing of information

- Without prejudice to the provisions of section 44, if any person, who furnishes or is required to furnish under this Act any particulars, documents or any information,-
  a. makes any statement or furnishes any document which he knows or has reason to believe to be false in any material particular; or
  b. omits to state any material fact knowing it to be material; or
  c. wilfully alters, suppresses or destroys any document which is required to be furnished as aforesaid, the Commission shall impose on such person a penalty which may extend to rupees ten lakhs.
- Without prejudice to the provisions of sub-section (1), the Commission may also pass such other order as it deems fit.

Power to impose lesser penalty

- The Commission may, if it is satisfied that any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have

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violated section 3, has made a full and true disclosure in respect of the alleged violations and such disclosure is vital, impose upon such producer, seller, distributor, trader or service provider a lesser penalty as it may deem fit, than leviable under this Act or the rules or the regulations: Provided that lesser penalty shall not be imposed by the Commission in cases where proceedings for the violation of any of the provisions of this Act or the rules or the regulations have been instituted or any investigation has been directed to be made under section 26 before making of such disclosure:

- Provided further that lesser penalty shall be imposed by the Commission only in respect of a producer, seller, distributor, trader or service provider included in the cartel, who first made the full, true and vital disclosures under this section: Provided also that the Commission may, if it is satisfied that such producer, seller, distributor, trader or service provider included in the cartel had in the course of proceedings,-
  a. not complied with the condition on which the lesser penalty was imposed by the Commission; or
  b. had given false evidence; or
  c. the disclosure made is not vital, and thereupon such producer, seller, distributor, trader or service provider may be tried for the offence with respect to which the lesser penalty was imposed and shall also be liable to the imposition of penalty to which such person has been liable, had lesser penalty not been imposed.

Check Your Progress

3. Which chapter of the Competition Act provides for the provisions for various offences under the Act?
4. What is the penalty for making false statement or omission to furnish material information?

9.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The objective of the Competition Act, 2002 is to provide for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India.
2. The Competition Act provides that there shall be established by the Central Government a Commission to be called the Competition Commission of India, consisting of a Chairperson and not less than two and not more than six other members.

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3. Chapter VI of the Competition Act provides for the provisions for various offences under the Act.
4. If any person, being a party to a combination, makes a statement which is false in any material particular, or knowing it to be false; or omits to state any material particular knowing it to be material, such person shall be liable to a penalty which shall not be less than rupees fifty lakhs but which may extend to rupees one crore, as may be determined by the Commission.

9.5 SUMMARY

- The common law doctrine of 'restraint of trade' has played a crucial role in the development of modern competition law. The essence of this doctrine is that it is contrary to public policy to enforce contracts that are in the nature of unreasonable restraints of trade.
- The main provisions of the Competition Act pertain to prohibition of anti-competitive agreements; prevention of abuse of dominant position and regulation of combinations.
- In competition law, restraints have been broadly categorized into horizontal and vertical. Horizontal agreements are agreements between firms which operate at the same market level. Vertical agreements are between firms that are in some supply relationship.
- Horizontal agreements are almost always of concern to competition authorities, as these agreements tend to increase the chances of monopoly.
- Section 3(4) of the Act deals with vertical agreements. It lists five types of vertical agreements: tying, exclusive supply, exclusive distribution, refusal to deal, and resale price maintenance, which would be in contravention of Section 3(1), only if they cause or are likely to cause appreciable adverse effects on competition in India.
- The Act provides for the establishment of a Competition Commission of India to protect the interests of consumers.
- The Act provides for regulation of combination through mergers and acquisitions which causes or is likely to cause an appreciable effect on competition.
- Chapter VI of the Competition Act provides for the provisions for various offences under the Act.

9.6 KEY WORDS

- **Restraint of Trade:** It refers to any action that interferes with free competition in a market.

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- **Horizontal Agreements:** These are the agreements between firms which operate at the same market level.
- **Vertical Agreements:** These are the agreements between firms that are in some supply relationship.

9.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What is the meaning and scope of the Competition Act, 2002?
2. What is the objective of the Competition Commission of India?
3. List the cases in which the Central Government can allow exemptions from the Competition Act, 2002.

Long-Answer Questions

1. Discuss the salient features of the Competition Act, 2002.
2. Identify the various offences and penalties under the Competition Act, 2002.

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UNIT 10 INTELLECTUAL PROPERTY RIGHTS

NOTES

Structure

10.0 INTRODUCTION

The term 'intellectual property right' (IPR) comprises of three words, 'intellectual', 'property' and 'right'. Students of law understand that these words are different and have their own meaning. To understand the complete meaning of the term intellectual property right, one must look at each of these words one by one.

Intellectual means 'a person who places a high value on or pursues things of interest to the intellect or the more complex forms and fields of knowledge, like aesthetic or philosophical matters, especially on an abstract and general level'. On the other hand, the word property has been defined by different philosophers differently.

Various jurists have given different categories to rights; one finds that rights can be tangible and intangible. The rights which are normally possessed by a person in physical form are tangible, while the rights in the form of goodwill, image in society, copyright, trademark, patent, shares, etc., are intangible rights. Whether rights are tangible and intangible, all rights need to be protected by law. This can only be possible if the person who claims it to be his/her own should have de-jure ownership over it. This can be only possible if there is abidance of legal procedure.

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Thus, the term Intellectual Property Right can be understood to be the right of ownership of property which is the outcome of the application of the intellect of a person. The application of the intellect is in different fields like inventions, designs for industrial articles, literary, artistic work, symbols that are ultimately used in commerce. Intellectual property rights define a variety of legal rights in protecting products of intellectual efforts of creativity in the fields of applied art, knowledge and fine arts.

These rights are statutory rights which need protection through various statutes. These intellectual property rights are classified into different categories, they include: Patent, Industrial Design, Trademarks, Copyright, Geographical Indications, Lay out designs of integrated circuits and Protection of undisclosed information/Trade Secret according to TRIPs agreements.

10.1 OBJECTIVES

After going through this unit, you will be able to:

- Describe what intellectual property rights mean
- Discuss the meaning and scope of the Patent Act
- Identify the WTO Agreements on patents
- Discuss the rights of patentee and patent infringement provisions
- Explain the provisions relating to trademarks and copyright

10.2 MEANING AND SCOPE OF PATENT ACT

It is a quintessential principle of patent legislation in India that a patent is granted only for inventions which are new and useful and which have industrial application. This principle is evident from the definition of invention. Secondly, it is not considered in public interest to grant patent rights in respect of discoveries of a scientific principle or an invention injurious to public health, or a method of agricultural or horticulture or a process for the treatment of human beings, animals or plants. The consideration for granting a patent is through the disclosure of the invention in the detailed specification which is open to public inspection so that on expiry of the term of the patent any member of the public can use the invention. The State can impose any conditions/restrictions while granting a patent monopoly. To prevent the abuse of monopoly rights created by grant of patent, the Patent Act provides for compulsory licensing of the patented invention on certain grounds.

10.2.1 Indian Patent Act, 1970

The patent law of India has the following salient features that decide whether a patent will be granted or not:

(a) **The object:** The object of patent law is to encourage scientific research, new technology and industrial progress. The price of the grant of the monopoly is the disclosure of the invention at the Patent Office, which, after the expiry of the fixed period of the monopoly, passes into the public domain.

(b) **Inventive step:** The fundamental principle of patent law is that a patent is granted only for an invention which must have novelty and utility. It is essential for the validity of a patent that it must be the inventor's own discovery as opposed to mere verification of what was, already known before the date of the patent.

(c) **Useful:** The previous Act, i.e., the Act of 1911, does not specify the requirement of being, useful, in the definition of 'invention", but courts have always taken the view that a patentable invention, apart from being a new manufacture, must also be useful.

(d) **Improvement:** In order to be patentable, an improvement on something known before or a combination of different matters already known, should be something more than a mere workshop improvement, and must independently satisfy the test of invention or an inventive step. It must produce a new result, or a new article or a better or cheaper article than before. The new subject matter must involve "invention" over what is old. Mere collocation of more than one, integers or things, not involving the exercise of any inventive faculty does not qualify for the grant of a patent.

(e) **The guiding tests:** To decide whether an alleged invention involves novelty and an inventive step, certain broad criteria can be indicated. Firstly if the 'manner of manufacture' patented, was publicly known, used or practiced in the country before or at the date of the patent, it will be negative novelty or `subject matter'. Prior public knowledge of the alleged invention can be by word of mouth or by publication through books or other media. Secondly, the alleged discovery must not be the obvious or natural suggestion of what was previously known.

In short the 'invention' must involve an inventive step and the same must be capable of 'industrial application'. It must be supplemented by the concept of 'non-obviousness'.

Patents Rules

Under the provisions of Section 159 of the Patents Act, 1970, the Central Government is empowered to make rules for implementing the Act and regulating patent administration. Accordingly, the Patents Rules, 1972 were notified and brought into force w.e.f. 20.4.1972. These rules were amended from time to time till 20 May 2003, when new Patents Rules, 2003, were brought into force by replacing the 1972 rules. These rules were further amended by the Patents (Amendment) Rules, 2005 and the Patents (Amendment) Rules, 2006. The last amendments are made effective from 5 th May 2006.

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Advantage of Patent Rights

A patent does not give a right to make or use or sell an invention. Rather, a patent provides the right to exclude others from making, using, selling, offering for sale, or importing the patented invention for the term of the patent, which is usually 20 years from the filing date subject to the payment of maintenance fees. A patent is a limited property right the government gives inventors in exchange for their agreement to share details of their inventions with the public. Like any other property right, it may be sold, licensed, mortgaged, assigned or transferred, given away, or simply abandoned.

Patented inventions have, in fact, pervaded every aspect of human life, from electric lighting (patents held by Edison and Swan) and plastic (patents held by Baekeland), to ballpoint pens (patents held by Biro) and microprocessors (patents held by Intel).

All patent owners are obliged, in return for patent protection, to publicly disclose information on their invention in order to enrich the total body of technical knowledge in the world. Such an ever-increasing body of public knowledge promotes further creativity and innovation in others. In this way, patents provide not only protection for the owner but valuable information and inspiration for future generations of researchers and inventors.

Thus, patents provide incentives to individuals by offering them recognition for their creativity and material reward for their marketable inventions. These incentives encourage innovation, which assures that the quality of human life is continuously enhanced.

10.2.2 Amendment in WTO Agreements on IPR

The amendment to the WTO Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement in 2017 marks the first time since the organization opened its doors in 1995 that WTO accords have been amended. Members took the decision to amend the TRIPS Agreement specifically to adapt the rules of the global trading system to the public health needs of people in poor countries. This action was peceded by repeated calls from the multilateral system for acceptance of the amendment.

This is an extremely important amendment. It gives legal certainty that generic medicines can be exported at reasonable prices to satisfy the needs of countries with no pharmaceutical production capacity, or those with limited capacity. By doing so, it helps the most vulnerable access the drugs that meet their needs, helping to deal with diseases such as HIV/AIDS, tuberculosis or malaria, as well as other epidemics.

Unanimously adopted by WTO members in 2005, the protocol amending the TRIPS Agreement makes permanent a mechanism to ease poorer WTO members' access to affordable generic medicines produced in other countries. The amendment empowers importing developing and least-developed countries

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facing public health problems and lacking the capacity to produce drugs generically to seek such medicines from third country producers under "compulsory licensing" arrangements. Normally, most medicines produced under compulsory licences can only be provided to the domestic market in the country where they are produced. This amendment allows exporting countries to grant compulsory licences to generic suppliers exclusively for the purpose of manufacturing and exporting needed medicines to countries lacking production capacity.

10.2.3 Rights of Patentee

Grant of Patent: Where an application for a patent has been found to be in order for grant of the patent, the patent shall be granted as expeditiously as possible to the applicant with the seal of the patent office and the date on which the patent is granted shall be entered in the register.

On the grant of the patent, the controller shall publish the fact that the patent has been granted and thereupon the application, specification and other documents related to the patent shall be open for public inspection (Sec. 43)

Date of Patent: Every patent shall be dated as of the date on which the application for the patent was filed. (Sec. 45)

Form, Extent and Effect of Patent: Every patent shall be in the prescribed form and shall have effect throughout India. A patent shall be granted for one invention only. (Sec. 46)

Rights of Patentee: The patent granted under this Act shall confer upon the patentee the exclusive right to prevent third parties, who do not have his consent, from the act of making, using, offering for sale, selling or informing for those purposes the patented product in India. (Sec. 48)

Term of Patent: The term of every patent shall be twenty years from the date of filing the application for the patent. (Sec. 53)

10.2.4 Patent Infringement and Remedies

Generally speaking, the following acts when committed without the consent of the patentee shall amount to infringement:

- making, using, offering for sale, selling, importing the patented product
- using the patented process, or using, offering for sale, selling or importing the product directly obtained by that process

Exclusions from Infringement

The law however enumerates certain exceptions to infringement:

(a) **Experimental and Research:** Any patented article or process can be used for the following purposes:
   - Experiment
   - Research
   - Instructing the pupils

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It is also permitted to make, construct, use, sell or import a patented invention solely for the uses reasonably related to the development and submission of information required under any law for the time being in force, in India, or in a country other than India, that regulates the manufacture, construction, use, sale or import of any product. All such acts, if within the bounds as created above, cannot be challenged as infringing the rights of the patentee.

(b) **Parallel Importation under certain conditi** Patented article or article made by using the patented process can be imported by government for its own use. Also a patented process can be used by the government solely for its own use. Moreover, the government can import any patented medicine or drug for the purposes of its own use or for distribution in any dispensary, hospital or other medical institution maintained by the government or any other dispensary, hospital or medical institution notified by the government.

Remedies

For filing a suit for infringement, the Court of first instance in India is the District Court. Now, where in such a suit the defendant pleads invalidity of the patent and makes a counter claim for revocation of the patent, the suit of infringement along with the counter claim is necessarily transferred to the High Court having Jurisdiction. As a matter of practice, in almost all the suits of infringement the defendant challenges the validity of the patent and makes a counter-claim for revocation. The effect of this is that infringement suits are generally decided by the High courts. In *Low Heat Driers (P) Ltd. v. Biju George [2001 (21) PTC 775 (Ker)]* it was held that once the defendants file a counter claim seeking revocation of patent, the District Court will lose jurisdiction to proceed with the matter any further. That deprivation of power will necessarily include the power to deal with all interlocutory applications pending as on that day.

Like any other civil suit the jurisdiction shall be determined in accordance with the rules of Code of civil procedure. The appropriate forum would be:

(a) Principal place where the plaintiff carries on his business; or

(b) Principal place where the defendant carries on his business; or

(c) Place where the infringing articles are manufactured/sold or infringing process is being applied or where the articles manufactured by the infringing process is being sold;

Burden of Proof

The traditional rule of burden of proof is adhered to with respect to patented product and accordingly in case of alleged infringement of a patented product the 'onus of proof' rests on the plaintiff. However, TRIPS-prompted amendment has resulted in 'reversal of burden of proof' in case of infringement of patented process. Under the current law, the Court can at its discretion shift the burden of proof on the defendant, in respect of process patent if either of the two conditions are met: 1) the process results in 'new' product or 2) there is substantial likelihood that an

identical product is made by the process and plaintiff has made reasonable efforts to determine the process but has failed.

Declaration as to non-infringement

Infringement suits are dilatory, may hamper the flow of business and involve considerable costs. To keep them at bay, a suit for declaration as to non-infringement can be instituted. For this the plaintiff must show that following: (a) the plaintiff applied in writing to the patentee or his exclusive licensee for a written acknowledgement to the effect that the process used or the article produced by him does not infringe the patent and (b) patentee or the licensee refused or neglected to give such an acknowledgement. It is not necessary that the plaintiff must anticipate an infringement suit.

Relief in Suit for Infringement

When speaking of any legal proceeding, probably the most important concern in the nature and scope of relief available to the 'aggrieved party'. It is seen that like any other civil proceedings, the infringement suits are often protracted and if the aggrieved party were made to wait till the end, the damage inflicted would be irreparable.

Check Your Progress

1. What is the objective of the patent law?
2. What is the term of a patent under Indian law?
3. Where does the onus of proof lie in case of infringement of patent?

10.3 TRADEMARKS

The Trade Marks Act, 1999 was enforced on September 15, 2003 and was amended by Trade Marks (Amendment) Act, 2010 which now governs trademark laws in India. The new Act was implemented to introduce various other provisions in conformity with the International trademark Legislations. The Indian Intellectual Property Office (IIPO) is the primary office, which comprises of the Trade Marks Registry, the Patent Office, and the Designs Office in India. The Trade Marks Registry has 5 branches in India. They are located at New Delhi, Mumbai, Chennai, Kolkata and Ahmedabad. The functioning of the Trade Marks Registry is decentralized and all offices are empowered to handle cases of their jurisdiction. The five Trade Mark Offices share a central database and any registrations or decisions issued by such branches are valid all over India.

While an Indian applicant has to file applications in the registry in its zone, a foreign applicant can choose to file an application where its representative law firm has an office. In India, one can protect a trademark for goods or services, on the basis of either use or registration or on basis of both elements. A registration of a

trademark is always granted only for a limited period of time, but it is renewable without restriction in time. Therefore, a trademark may be protected indefinitely. The trademark signifies the quality of product and services of the trademark owner; it is in the interest of corporations or individuals to get the trademark registered in India to exclude others from using the same or deceptively similar trademark in India.

With effect from September 15, 2003, Trade Marks Act, 1999 have been enforced, old Trademarks and Mechandising Act, 1958 has been repealed. The new Trade Marks Act 1999 is TRIPS compliant and more in conformity with US Federal and State Trade Marks laws than it was earlier. Service Marks are now registrable in India.

Types of Trademarks

A trademark is designated by the following symbols:

- ™ (for an unregistered trade mark, that is, a mark used to promote or brand goods)
- ®, (for an unregistered service mark, that is, a mark â„ superscript SM used to promote or brand services)

Trademark and Service Marks: Trademarks and Service Marks are those that are affixed to identify goods or services of certain producers.

The different types of trademarks which are available for adoption are:

- Any name (including personal or surname of the applicant or predecessor in business or the signature of the person), which is not unusual for trade to adopt as a mark.
- An invented word or any arbitrary dictionary word or words, not being directly descriptive of the character or quality of the goods/service.
- Letters or numerals or any combination thereof.
- The right to proprietorship of a trademark may be acquired by either registration under the Act or by use in relation to particular goods or service.
- Devices, including fancy devices or symbols.
- Monograms.
- Combination of colours or even a single colour in combination with a word or device.
- Shape of goods or their packaging.
- Marks constituting a 3- dimensional sign.
- Sound marks when represented in conventional notation or described in words by being graphically represented.

10.3.1 Transfer and Infringement of Trademarks

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Let us now study how trademarks can be transferred from one holder to another. Trademarks can be transferred through assignment, transmission and licensing.

Assignment means an assignment in writing by an act of the parties concerned. While in case of licensing, the right in the trademark continues to vest with the proprietor, the assignment of the trademark leads to a change in the ownership of the mark. A registered trademark is assignable with or without the goodwill in respect of all or only some of the goods/services for which the mark is registered. India is a member to TRIPS and Article 21 of the TRIPS dealing with Licensing and Assignment mandates that '... the owner of a registered trademark shall have the right to assign the trademark with or without the transfer of the business to which the trademark belongs.' Section 39 of the (Indian) Trade Marks Act, 1999 allows for the assignment of an unregistered trademark with or without the goodwill of the business concerned.

Indian law contains embargo on the assignments of trademark, whether registered or unregistered, whereby multiple exclusive rights would be created in more than one person which would result in deception/confusion. However, the assignment with limitations imposed, such as goods to be sold in different markets, i.e., within India or for exports are valid. The Registrar is authorized to issue a certificate of validity of the proposed assignment on a statement of case by the proprietor of a registered trademark who proposes to assign the mark. The said certificate as to validity is conclusive unless vitiated by fraud.

10.3.2 Infringement of Trademarks and its Remedies

Trademark Infringement is a violation of exclusive rights attaching to a trademark without the authorization of the trademark owner or any licensee. Trademark infringement mostly occurs when a person uses a trademark which may be either a symbol or a design, with resembles to the products owned by the other party. The trademark owner may begin a legal proceeding against a party, which infringes its registration.

There are two types of remedies available to the owner of a trademark for unauthorized use of its imitation by a third party. These remedies are:-an action for passing off in the case of an unregistered trademark and an action for infringement in case of a registered trademark. An infringement action and an action for passing off is quite different from each other, an infringement action is a statutory remedy and an action for passing off is a common law remedy. Accordingly, in order to establish infringement with regard to a registered trademark, it is necessary only to establish that the infringing mark is deceptively similar to the registered mark and no further proof is required. In the case of a passing off action, proving that the marks are deceptively similar alone is not sufficient. The use of the mark should be likely to deceive confusion. Further, in a passing off action it is necessary to prove that the use of the trademark by the defendant is likely to cause injury to the plaintiff's goodwill, whereas in an infringement suit, the use of the mark by the

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defendant need not cause any injury to the plaintiff. Trademark infringement laws help the trademark holders to keep awareness about infringement of trademark.

Under the Trade Marks Act, both civil and criminal remedies are simultaneously available against infringement and passing off. Infringement of trademark is violation of the exclusive rights granted to the registered proprietor of the trademark to use the same. A trademark is said to be infringed by a person, who, not being a permitted user, uses an identical/ similar/ deceptively similar mark to the registered trademark without the authorization of the registered proprietor of the trademark. However, it is pertinent to note that the Indian trademark law protects the vested rights of a prior user against a registered proprietor which is based on common law principles. Passing off is a common law tort used to enforce unregistered trademark rights. Passing off essentially occurs where the reputation in the trademark of party A is misappropriated by party B, such that party B misrepresents as being the owner of the trademark or having some affiliation/ nexus with party A, thereby damaging the goodwill of party A. For an action of passing off, registration of a trademark is irrelevant.

In an action for passing off under the law of trademarks, it is essential to prove that the consumer is misled into believing that the impugned goods are the goods of or are connected with the goods of a prior user of the trademark. When this is not proved, the prior user cannot enforce a passing off action against the new user, even if the goods in relation to which the trademark is used fall in the same class. This was the view taken by the Delhi High Court in the case of *M/s Microlube India Ltd. v. Maggon Auto Centre and Another*, decided on 7th February 2008.9

In the case, the plaintiffs were the registered users of the trademark MICO registered in relation to their petroleum products including oils, grease, lubricants and coolants. They filed a suit for infringement and passing off against the defendants for using the same mark in relation to their lubricants and also got an ex parte order. When the defendants contented that they could not be restrained from the use of the trademark by the plaintiffs in view of Section 28(3) of the Trademarks Act, 1999 which relates to concurrent use of trademarks by two persons; the plaintiffs took help of Sections 27(2), 33 and 34 of the Trademarks Act 1999 as having an overriding effect on Section 28, and made their ground for the relief of passing off.

However, the defendants averred that the plaintiffs had suppressed material facts and did not inform the court about the fact of registration of the trademark MICO by the defendant in 2005, thereby misleading the court that the latter were an unregistered user. Also, there was lack of research and misidentification of the principal parties by the plaintiffs, which led to non-presence of the defendants at the time of first hearing and obtaining of ex parte order by the plaintiffs. The plaintiffs argued that no provision of the Act bars an action for passing off by an anterior user of a trademark against a registered user of the same. Under section 27(2) of the Act, a prior user of a trade mark can maintain an action for passing off against any subsequent user of an identical trade mark including a registered user thereof.

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The defendants further questioned the validity of the passing off action of plaintiffs, contending that the requirements for the claim were not met. 'The law of Passing Off as it has developed permits an action against a registered proprietor of a trade mark for its mendacious use for inducing and misleading the consumers into thinking that his goods are the goods of or are connected with the goods of a prior user of the trade mark.'

10.4 COPYRIGHT

As you learned, copyright is a right given by the law to creators of literary, dramatic, musical and artistic works and producers of cinematograph films and sound recordings. In fact, it is a bundle of rights including, *inter alia,* rights of reproduction, communication to the public, adaptation and translation of the work. There could be slight difference in the symphony of the rights depending on the work done and the medium selected by the person. The Copyright Act, 1957 protects original literary, dramatic, musical and artistic works and cinematograph films and sound recordings from unauthorized uses. Unlike the case with any other IPR, copyright protects the expressions and not the ideas. There is no copyright on an idea. The most important thing that need to be proved to be worthy of the copyright is to have the originality of the work. Originality is a word which has been expressed by various courts in different matters but the conclusion of the same can be expressed as what was held in the Privy Council in the MacMillan case1. In this the Privy Council held that an original work is the product of the labour, skill and capital of one man which must have been distinct and not appropriated by the other.

Copyright ensures certain minimum safeguards of the rights of authors over their creations, thereby protecting and rewarding creativity. Creativity being the cornerstone of progress, no civilized society can afford to ignore the basic requirement of encouraging the same. Economic and social development of a society is dependent on creativity. The protection provided by copyright to the efforts of writers, artists, designers, dramatists, musicians, architects and producers of sound recordings, cinematograph films and computer software, creates an atmosphere conducive to creativity, which induces them to create more and motivates others to create.

An idea cannot be protected by the copyright, as the protection lies only in the expression in any dimension. If in any instance the idea of one person has been shared or taken up by the other, it cannot be protected under any provision of law. The Apex court of India in the R.G. Anand case held that copyright does not lie in the idea or any plot, it lies only to an expression.

Copyright does not ordinarily protect titles by themselves or names, short word combinations, slogans, short phrases, methods, plots or factual information. Copyright does not protect ideas or concepts. To get the protection of copyright a work must be original. But in cases of the celebrities like Lata Mangeshkar or Shilpa Shetty endorsing their own launched products with their names, they can have protection as trademarks, but they cannot get copyright over their names.

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The broad imperative is that copyright lasts for life time of the creator and 60 years after the death of the copyright holder. This is true in case of original literary, dramatic, musical and artistic works. The 60-year period is counted from the year following the death of the author. In the case of cinematograph films, sound recordings, photographs, posthumous publications, anonymous and pseudonymous publications, works of government and works of international organizations, the 60-year period is counted from the date of publication.

10.4.1 Transfer and Infringement of Copyright

Let us now study the transfer of copyright in India. Like any other type of the property, copyright is also transferable. They can be transferred through different ways. The contractual way of transferring copyright is called the assignment. The other way of transfer of copyright is through the deposition of the same to the government of India, which can also be understood as the surrender of IPR.

Assignment of Copyright

The owner of copyright in an existing work or the prospective owner of the copyright in a future work may assign to any person the copyright either wholly or partially and either generally or subject to limitations and either for the whole term of the copyright or any part thereof. The assignment should be in writing signed by the assignor or by his duly authorized agent. It shall identify the specific works and specify the rights assigned and the duration and territorial extent of such assignment. It shall also specify the amount of royalty payable, if any, to the author or his legal heirs during the currency of the assignment and the assignment shall be subject to revision, extension or termination on terms mutually agreed upon by the parties. Where the assignee does not exercise the rights assigned to him within a period of one year from the date of assignment, the assignment is deemed to have lapsed after the expiry of one year. Usually the period of the assignment depend on the terms of the contract between the parties, but if it is not stated, it is presumed to be five years from the date of assignment. Similarly if the territorial extent of assignment of the rights is not specified, it shall be presumed to extend within the whole of India.

As mentioned earlier, the author of a work may surrender all or any of the rights comprising the copyright in the work by giving notice in the prescribed form to the registrar of copyrights.

10.4.2 Infringement of Copyright

The following are some of the commonly known acts involving the infringement of copyright:

- Making infringing copies for sale or hire or selling or letting them for hire;
- Permitting any place for the performance of works in public where such performance constitutes infringement of copyright;
- Distributing infringing copies for the purpose of trade or to such an extent so as to affect prejudicially the interest of the owner of copyright;

- Public exhibition of infringing copies by way of trade; and
- Importation of infringing copies into India.

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Normally we find that the court of justice under whose jurisdiction such type of violation is taking place will have the power to take cognizance of the infringement. They can award damages as well as fine the wrong doer. Along with this, the person whose rights have been infringed upon can also ask for any appropriate remedy. Usually such cases are tried by the Metropolitan Magistrate or a Judicial Magistrate of the first class, under whose jurisdiction such violation is committed. Where any infringement takes place at the premises of third person and he also gets the gains out of such an activity, that person can also be held for copyright violation under the provision of the Act, unless the person has evidence to show that he was not aware and had no reasonable ground for believing that such communication to the public would be an infringement of copyright.

The copies which are made through the infringement of the copyrighted material are also subjected to the retention of the owner and it would be deemed to be his own property, as the original work. The investigation of the violations would be tried by any police officer, not below the rank of a sub inspector on his satisfaction that an offence in respect of the infringement of copyright in any work has been, is being, or is likely to be committed, seize without warrant, all copies of the work and all plates used for the purpose of making infringing copies of the work, wherever found, and all copies and plates so seized shall, as soon as practicable be produced before a magistrate.

10.4.3 Remedies for the Infringement of Copyright

There are two types of remedies that are available to the violation of any copyright in India, which encompass civil and criminal remedies. In terms of civil remedies, the copyright owner is entitled to remedies for the infringement of copyright by way of injunctions, damages and accounts of profits.

Any person who knowingly infringes or abets the infringement of the copyright in any work commits criminal offence under Section 63 of the Copyright Act. Criminal remedies include imprisonment, with fine as well as the seizure of the infringed material and sharing of the profits of the infringed sale. The minimum punishment for infringement of copyright is imprisonment for six months with the minimum fine of ₹ 50,000. In the case of a second and subsequent conviction the minimum punishment is imprisonment for one year and fine of ₹ two lakh.

10.4.4 Copyright Amendment Bill 2010

The copyright amendment bill 2010 which has been floating in abeyance since quite long was finally introduced before the Rajya Sabha (Upper House of the Parliament) on 19th April, 2010. The said bill proposes various substantial changes in the copyright law mainly addressing the concerns of the entertainment industry in respect of the law on 'version recording', 'parallel imports', and rights of the director of a film. The various noteworthy proposals are as follows:

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(i) New Copyright included in the Bundle - The bill amends the meaning of copyright per se by including, storage of work on any medium by electronic or other means and 'commercial rental of a copy of work' (not for artistic work) as a part of the bundle of rights to which the owner of an artistic work, film and sound recording is entitled.

(ii) Recognizing the Rights of a Film Director – The bill for the first time recognizes the principle director of a cinematograph film as its joint first owner and also a co-author along with the producer thereof while film itself would be a work of joint authorship.

(iii) Numerous exceptions to Copyright Infringement Introduced – The bill takes special note of incidental/transient copying or storage of a work for private purposes as Fair Use of the work not amounting to copyright infringement. Importantly, the bill further protects making of a Three-Dimensional Object from a two-dimensional/technical drawing from liability under infringement if such Three-Dimensional object is made for the purposes of industrial application of any purely functional part of a useful device.

(iv) Introduction of Digital Rights Management Provisions - With special emphasis on better protection and management of copyright the bill enacts new provisions for rights management information system containing authentic data about the identity of each copyright work or performance so as to identify the author/owner thereof and terms and conditions of use, if any, existing on such work. The Bill also provides for strict protection of such technological measures taken for protection of copyright and lays down harsh criminal punishments for any circumvention of the said technological measures.

(v) Statutory Licensing of Version Recordings - Catering specifically to the demands of the entertainment industry especially the music industry, the bill provides for statutory licensing of version recordings/cover versions of songs and lays down a scheme of giving prior notice and advance royalty to the author of the original version.

(vi) Statutory Licensing of Broadcast - The bill further provides a set of conditions and guidelines for the broadcast of any published work by a broadcasting organization under the terms of a statutory license from the owner of copyright.

Besides, the aforesaid, the Copyright Amendment Bill, 2010 also seeks to make vast changes in respect of the provisions relating to assignment, receipt of royalties, term of copyright in photograph, etc., and in effect causes a major overhaul of the existing copyright law in order to achieve greater international parity and make the copyright law of the country internationally uniform.

(vii) E-Filing of Copyright Applications – The system of electronic filing of copyright applications has been introduced since the last year and is expected to start functioning with all its might by the end of the present year.

(viii) **Digitization of Data and Online Search facility** - The government has also initiated steps for complete digitization of all data related to copyright registration and set up a system of online public search of such data including registered as well as pending copyright applications on the same lines as already available with the trademark, patent registries.

(ix) **Complete Overhaul of the Copyright Board** – Taking note of the directions passed by Ld. Delhi High Court (Division Bench in WP 2516 of 2010) in a writ petition started suo moto by the court, the central government has initiated steps towards a complete overhaul of the administrative setup of the Copyright Board including steps such as providing a new, permanent office, recruitment of permanent staff and permanent judges etc.

Check Your Progress

4. What are trademarks and service marks?
5. What does a copyright ensure?
6. What is the minimum punishment for infringement of copyright?

10.5 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The objective of patent law is to encourage scientific research, new technology and industrial progress.
2. The term of every patent according to Indian law is twenty years from the date of filing the application for the patent.
3. The traditional rule of burden of proof is adhered to with respect to patented product and accordingly in case of alleged infringement of a patented product the 'onus of proof' rests on the plaintiff.
4. Trademarks and service marks are those that are affixed to identify goods or services of certain producers
5. Copyright ensures certain minimum safeguards of the rights of authors over their creations, thereby protecting and rewarding creativity.
6. The minimum punishment for infringement of copyright is imprisonment for six months with the minimum fine of ₹ 50,000.

10.6 SUMMARY

- It is a quintessential principle of patent legislation in India that a patent is granted only for inventions which are new and useful and which have industrial application.

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- The consideration for granting a patent is through the disclosure of the invention in the detailed specification which is open to public inspection so that on expiry of the term of the patent any member of the public can use the invention.
- To decide whether an alleged invention involves novelty and an inventive step, certain broad criteria can be indicated.
- Under the provisions of Section 159 of the Patents Act, 1970 (as amended in 2003), the Central Government is empowered to make rules for implementing the Act and regulating patent administration.
- Where an application for a patent has been found to be in order for grant of the patent, the patent shall be granted as expeditiously as possible to the applicant with the seal of the patent office and the date on which the patent is granted shall be entered in the register.
- The traditional rule of burden of proof is adhered to with respect to patented product and accordingly in case of alleged infringement of a patented product the 'onus of proof' rests on the plaintiff.
- The Trade Marks Act, 1999 was enforced on September 15, 2003 and was amended by Trade Marks (Amendment) Act, 2010 which now governs trademark laws in India. The new Act was implemented to introduce various other provisions in conformity with the International trademark Legislations.
- Under the Trade Marks Act, both civil and criminal remedies are simultaneously available against infringement and passing off.
- Copyright ensures certain minimum safeguards of the rights of authors over their creations, thereby protecting and rewarding creativity.
- The owner of copyright in an existing work or the prospective owner of the copyright in a future work may assign to any person the copyright either wholly or partially and either generally or subject to limitations and either for the whole term of the copyright or any part thereof.

10.7 KEY WORDS

- **Intellectual Property:** It is a category of property that includes intangible creations of the human intellect.
- **Patent:** It refers to a government authority or licence conferring a right or title for a set period, especially the sole right to exclude others from making, using, or selling an invention.
- **Assignment:** It means an assignment in writing by an act of the parties concerned.

- **Trademark Infringement:** It refers to a violation of exclusive rights attaching to a trademark without the authorization of the trademark owner or any licensee.
- **Copyright:** It is a right given by the law to creators of literary, dramatic, musical and artistic works and producers of cinematograph films and sound recordings.

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10.8 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What are the advantages of patent rights?
2. List the exceptions to infringement under the Indian Patent Act.
3. What are different types of trademarks which are available for adoption?
4. List the acts that are considered as the infringement of copyright.

Long-Answer Questions

1. Discuss the salient features of the Indian Patent Act.
2. Explain the provisions for the transfer and infringement of trademarks in India.
3. List and describe the remedies available for the infringement of copyright.

10.9 FURTHER READINGS

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UNIT 11 INFORMATION TECHNOLOGY ACT, 2000

NOTES

Structure

11.0 INTRODUCTION

The term 'information technology' (IT) does not have a precise meaning. It is generally applied to a broad area of activities and technologies associated with the use of computers and communication. We can explain IT as an application of computers to create, store, process and use information particularly in the field of commerce. Basically, IT enables the corporate management to have access to timely, accurate and relevant data, with the use of computers, communication and telephone, Internet, etc., which helps in informed decision-making, minimizes the response time and enables better coordination in the organisation resulting in reduced costs or increased profits.

Cyber law is the law relating to communications and automatic control systems. Thus, cyber law covers: (i) Information technology law, which regulates transactions relating to computers and the internet, (ii) Communications Law, which regulates telecommunications and broadcasting, including radio, television, telephony and cable. It is covered by (i) the Indian Telegraph Act, 1885, (ii) the wireless telegraphy act, 1933, and (iii) the Cable Television Networks Regulation Act, 1995.

11.1 OBJECTIVES

After going through this unit, you will be able to:

- Discuss the rationale of IT Act, 2000

- Identify those documents where provisions of the IT Act, 2000, are not applicable
- Understand the law relating to digital signature
- Describe the provisions of IT Act, 2000 relating to e-governance
- Discuss the functions and duties of certifying authorities
- Explain the penalties for various offences under the IT Act, 2000

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11.2 INFORMATION TECHNOLOGY ACT: BACKGROUND AND SALIENT FEATURES

The 'Statement of Objects and Reasons' appended to the 'Informa-tion Technology Bill, 2000,' explains the rationale behind the IT Act, 2000. Excerpts from the said statement are given below:

'New communication systems and digital technology have made dra-matic changes in the way we live. A revolution is occurring in the way people transact business. Businesses and consumers are increasingly using computers to create, transmit and store information in the electronic form instead of traditional paper documents. Information stored in electronic form has many advantages. It is cheaper, easier to store, retrieve and speedier to communicate. Although people are aware of these advantages, they are reluctant to conduct business or conclude any transaction in the electronic form due to lack of appropriate legal framework. The two prin-cipal hurdles which stand in the way of facilitating electronic commerce and electronic governance are the requirements as to writing and signature for legal recognition. At present many legal provisions assume the existence of paper based records and documents, and records which should bear signatures. The law of evidence is traditionally based upon paper based records and oral testimony. Since electronic commerce elimi-nates the need for paper based transactions, hence to facilitate e-commerce, the need for legal changes have become an urgent necessity. International trade through the medium of e-commerce is growing rapidly in the past few years and many countries have switched over from tradi-tional paper based commerce to e-commerce.'

'There is a need for bringing in suitable amendments in the existing laws in our country to facilitate e-commerce. It is, therefore, proposed to provide for legal recognition of electronic records and digital signatures. This will enable the conclusion of contracts and the creation of rights and obligations through the electronic medium.'

'With a view to facilitate Electronic Governance, it is proposed to provide for the use and acceptance of electronic records and digital signatures in the Government offices and its agencies.'

The law relating to 'information technology' is contained in the Information Technology (IT) Act, 2000 which came into force on 17th October, 2000. It is the

first Cyber Law in India. It is mainly based on the UNCITRAL Model Law. The United Nations Commission on International Trade Law (UNCITRAL) adopted the Model Law on Electronic Commerce in 1996. This Model Law provides for equal legal treatment of users of electronic communication and paper based communication.

The Information Technology (IT) Act, 2000 has been designed to give boost to Electronic Commerce (e-commerce), e-transactions and similar activities associated with commerce and trade, and also to facilitate Elec-tronic Governance (e-governance) by means of reliable electronic records. With a view to making the citizens interaction with the Government offices hassle free, the IT Act provides for the use and acceptance of electronic records and digital signatures in the Government offices. To prevent the possible misuse arising out of the transactions and other dealings con-cluded over the electronic medium, the IT Act also provides for a regu-latory regime to supervise the Certifying Authorities issuing Digital Sig-nature Certificates. Briefly stated, it may be said that IT Act mainly con-tains provisions relating to e-commerce, e-governance, electronic record and digital signature.

A few minor amendments in the Act were made by Information Technology (Amendment) Act, 2002.

Electronic Commerce

The term Electronic Commerce (e-commerce) refers to the business transacted electronically. In common usage, the term refers to trading of goods over the Internet. It is online sale and purchase of goods and services for value by using internet technologies, such as internet processing, e-mail and world wide web (www) or just web browsing. E-commerce in its present form is in the stage of infancy in India. During the eight years of post IT Act period, the increase in e-commerce is taking place at a slow rate. From e-commerce standpoint, the major challenges offered by the Internet Technology are reliability, bandwidth, speed and security of transactions.

Internet

Electronic word has become the most popular form of commnication today. Electronic word is communicated through the Internet. The Internet system represents the network of networks under which the inter-connected computers the world over, communicate with each other and exchange data at a very high speed. In simple terms, Internet is a global network which connects various global servers and computers around the world using a standard protocol (TCP/IP).

For using Internet on a computer, one has to obtain an Internet connection from one of the various Internet Service Providers (ISPs). The ISP supplies a 'Modem' to the user which provides connectivity between the computer and the ISP server. The use of Internet does not require any special computer skills or training.

Today Internet is used by millions of people for sending and receiving e-mail, voice telephony, chatting and making friends, access to information and multimedia communications.

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Scheme of the IT Act, 2000

The Information Technology Act, 2000 consists of 13 Chapters di-vided into 94 Sections. Chapters I to VIII are mostly digital signature related. Chapters IX to XIII are regarding penalties, offences, etc. The Act has four Schedules on consequential amendments in respect of certain other Acts.

The First Schedule makes amendments to the Indian Penal Code, 1860, and the Second Schedule makes amendments to Indian Evidence Act, 1872 to provide for necessary changes in the various provisions which deal with offences relating to documents and paper based transactions. The Third Schedule makes amendments to the Bankers' Books Evidence Act, 1891 to give legal sanctity for books of account maintained in the elec-tronic form by the banks. The Fourth Schedule makes amendments to the Reserve Bank of India Act, 1934 to facilitate electronic fund transfers between the financial institutions and banks.

Exceptions [Sec. 1(4)]. The provisions of the IT Act, 2000 shall not apply to the following documents:

1. Execution of a Negotiable Instrument (other than a cheque) under the Negotiable Instruments Act, 1881.
2. Execution of a Power of Attorney under the Powers of Attorney Act, 1882.
3. Creation of a Trust under Indian Trusts Act, 1882.
4. Execution of a 'Will' under the Indian Succession Act, 1925 includ-ing any other testamentary disposition by whatever name called.
5. Entering into a contract for the sale or conveyance of immovable property or any interest in such property.
6. Execution of such class of documents or transactions as may be notified by the Central Government in the Official Gazette.

The reason for excluding the above-mentioned documents from the purview of the Act is that such documents are required to be authenti-cated only by the handwritten signatures. Moreover, these require special attestation and/or registration formalities, which also explain their exclu-sion.

With a view to facilitate electronic payments, the provisions of the IT Act, 2000 have been made applicable to a "cheque". The concept of an electronic cheque and the truncated cheque was introduced by the Information Technology (Amendment) Act, 2002, by inserting a new Section 81A. Accordingly, the definition of a cheque under the Negotiable Instruments Act was suitably amended, by the Amendment Act, 2002, and now it includes the electronic image of a truncated cheque and a cheque in the electronic form.

11.2.1 Digital Signature

The Law of Information Technology recognises the digital signature so that the Internet contract is authenticated and becomes binding on the parties. These are the electronic equivalent of the handwritten signatures. In an electronic message or transaction affixing handwritten signature is not possible. Authentication of the record has to be achieved by some electronic or digital method. 'Affixing digital signature' has been defined in Section 2(l)(*d*) of the Act to mean adoption of any methodology or procedure by a person for the purpose of authenticating an electronic record by means of 'digital signature'.

The expression 'digital signature' has been defined in Section 2(l)(*p*) of the Act to mean authentication of any electronic record by a subscriber, *i.e.,* a person in whose name the 'Digital Signature Certificate' is issued, by means of an electronic method or procedure in accordance with the provisions of Section 3.

Authentication of Electronic Records (Sec. 3)

Any subscriber may authenticate an electronic record by affixing his digital signature. The authentication of the electronic record shall be effected by the use of 'asymmetric crypto system' and 'hash function' which envelop and transform the initial electronic record into another electronic record.

Explanation — For the purposes of this sub-section, 'hash function' means an algorithm mapping or translation of one sequence of bits into another, generally smaller, set known as 'hash result' such that an elec-tronic record yields the same hash result every time the algorithm is executed with the same electronic record as its input making it computationally infeasible—

(*a*) to derive or reconstruct the original electronic record from the hash result produced by the algorithm;

(*b*) that two electronic records can produce the same hash result using the algorithm.

Verification. Any person by the use of a public key of the subscriber can verify the electronic record. The private key and the public key are unique to the subscriber and constitute a functioning key pair.

In the case of electronic transmission of business or legal message/ documents, it is necessary to ensure that these are authentic and have not been tampered with by any person during transmission. With this end in view, the above stated Section 3 provides that authentication of the elec-tronic record is to be effected by the use of 'asymmetric crypto system', *i.e.,* by using 'encryption' (coding) and 'decryption' (decoding) method-ologies and software tools.

An 'encryption software program' takes the normal, readable text message ('plaintext') and scrambles the message into unreadable coded text or 'ciphertext'. The recipient then uses another software program (the corresponding decryption program) to decrypt such ciphertext back into normal plaintext. Any one who

intercepts the message will, therefore, not be able to read or tamper with the message, unless he has the key, *i.e.,* the corresponding decryption program, thereby rendering it secure.

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In 'asymmetric crypto system', each person will have two corres-ponding and matched keys — one called the 'private key' which is always kept secure with such person, and the other called the 'public key' which the person shares with others and makes available to others on specialised databases called 'repositories' or through Certification Authorities. These two keys, public key and private key, are used to encrypt and decrypt the message respectively. The sender uses the intended receiver's public key (which he can freely obtain from the receiver or download from a public repository) to encrypt the message. The receiver, on receiving the coded message, uses his corresponding private key (which is available only with him) to decrypt the encrypted message. The public key and the private key of any person or entity would be so mathematically linked that a message encrypted using one key can only be decrypted by using the correspond-ing other.

Briefly stated, the use of digital signature involves the following procedure:

(*i*) To obtain digital signature, one has to apply in the prescribed form to the Certifying Authority (CA) together with the necessary documents such as proof of identity, proof of residence, etc., and the necessary fee.

(*ii*) The CA verifies the documents submitted. The case is approved if the documents are in order.

(*iii*) On approval, the CA issues a digital certificate to the applicant. It also provides a 'private key' and a 'public key' is to the applicant. The certificate guarantees that the holder of the 'public key' is the same person who holds the 'private key'. The certificate is digitally signed.

(*iv*) On receiving a digital certificate, the holder can use his distinct keys for the transmission of data or for other purposes. These keys are mathematically related and are used to encrypt and decrypt the digitally signed documents. One of the two keys can encrypt data and the other key can decrypt that data.

(*v*) The sender prepares the message to be sent including his name on a computer.

(*vi*) The sender applies a 'hash function' ('hash function' has already been defined above), *i.e.*, a mathematical formula or algorithm, in the form of a computer software, on the message to encrypt it using addressee's public key, which gives out a 'hash result', *i.e.*, a unique mathematical value. This 'hash result' is also called the 'message digest'.

(*vii*) The sender encrypts this 'message digest' further using his own 'private key'. The outcome of this encryption is accepted as the digital signature of the sender. In other words, the digital signature consists of this

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encrypted 'message digest'. This signature is unique to the message and will be different for each new message.

(*viii*) The sender typically attaches or appends his digital signature to the message.

(*ix*) The sender sends the digital signature and the encrypted message or unencrypted (original) message to the recipient electronically.

(*x*) The recipient uses the sender's 'public key' to verify the sender's digital signature. Verification using the sender's 'public key' proves that the message is authentic, unaltered and sent by the sender only.

(*xi*) The recipient also creates a 'message digest' of the message, using the same secure hash algorithm. If this 'message digest' is the same as the 'message digest' received from the sender, the receiver can be sure that no alteration has been made in the orginal message. The recipient can read the message by decrypting it with his 'private key'.

Digital signature is safer than a hand written one as it can't be forged. If a contract is signed by the parties on the last page, there is no way to find whether other pages have been tampered with. But digital signatures on the same contract will ensure that orginal contract is intact and not even a single letter is changed.

The various expressions used above have been defined in the Act as follows:

Asymmetric crypto system [Sec. 2(1)(*f*)]. It means a system of a secure key pair consisting of a private key for creating a digital signature and a public key to verify the digital signature.

Electronic record [Sec. 2(1)(*t*)]. It means data, record or data gener-ated, image or sound stored, received or sent in an electric form or micro-film or computer generated micro-fiche.

Key pair [Sec. 2(l)(*x*)]. In an asymmetric crypto system, 'key pair' means a private key and its mathematically related public key, which are so related that the public key can verify a digital signature created by the private key.

Private key [Sec. 2(l)(*zc*)]. It means the key of a key pair used to create a digital signature.

Public key [Sec. 2(l)(*zd*)]. If means the key of a key pair used to verify a digital signature and listed in the Digital Signature Certificate.

Subscriber [Sec. 2(l)(*zg*)]. It means a person in whose name the Digi-tal Signature Certificate is issued.

Verify [Sec. 2(l)(*zh*)]. 'Verify' in relation to a digital signature, elec-tronic record or public key, with the grammatical variations and cognate expressions means to determine whether—

(*a*) the initial electronic record was affixed with the digital signature by the use of private key corresponding to the public key of the sub-scriber;

(*b*) the initial electronic record is retained intact or has been altered since such electronic record was so affixed with the digital signature.

11.3 ELECTRONIC GOVERNANCE

The term Electronic Governance refers to the application of informa-tion technology to the processes of Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) governance. It involves electronic filing of documents with the government agencies and creating a network of e-services and e-adminstration. Electronic Governance (e-governance) is fast catching up and more and more government processes are going online resulting in less bureaucracy, more transparency and openness. It may be mentioned that electronic filing, using digital signatures, has been made mandatory for companies from 16th September, 2006. The companies will now be able to file any form, application or any other document in the electronic form online and make payment of fee by using credit card and Internet banking.

With a view to facilitating electronic governance, IT Act, 2000 accords legal recognition to electronic records, digital signatures and electronic form of dealing with Government offices and its agencies. The retention of information in electronic format has also been accorded legal recogni-tion provided the information remains accessible and usable in future. The Act contains the following provisions to facilitate e-governance:

1. **Legal Recognition of Electronic Records** (Sec. 4). Where any law provides that information or any other matter shall be in writing or in the typewritten or printed form, then, notwithstanding anything contained is such law, such requirement shall be deemed to have been satisfied if such information or matter is:
   (*a*) rendered or made available in an electronic form; and
   (*b*) accessible so as to be usable for a subsequent reference.
2. **Legal Recognition of Digital Signatures** (Sec. 5). Where any law provides that information or any other matter shall be authenticated by affixing the signature or any document shall be signed or bear the signature of any person then, notwithstanding anything con-tained in such law, such requirement shall be deemed to have been sat-isfied, if such information or matter is authenticated by means of digital signature affixed in such manner as may be prescribed by the Central Government.

   Explanation—For the purposes of this Section, 'signed', with its grammatical variations and cognate expressions, shall, with reference to a person, mean affixing of his handwritten signature or any mark on any document and the expression 'signature' shall be construed accordingly.

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3. **Use of Electronic Records and Digital Signatures in Government and its Agencies** (Sec. 6). Where any law provides for:
   (*a*) the filing of any form, application or any other document with any office, authority, body or agency owned or controlled by the appropriate Government in a particular manner;
   (*b*) the issue or grant of any licence, permit, sanction or approval by whatever name called in a particular manner;
   (*c*) the receipt or payment of money in a particular manner, then, notwithstanding anything contained in any other law for the time being in force, such requirement shall be deemed to have been satisfied in such filing, issue of grant, receipt or payment, as the case may be, is effected by means of such electronic form as may be prescribed by the appropriate Government.

   The appropriate Government may, by rules, prescribe:
   (*a*) the manner and format in which such electronic records shall be filed, created or issued;
   (*b*) the manner or method of payment of any fee or charges for filing, creation or issue of any electronic record under clause (*a*) stated above.

   It may be observed that this Section lays down the foundation of electronic governance.
4. **Retention of Electronic Records** (Sec. 7). Where any law provides that documents, records or information shall be retained for any specific period, then, that requirement shall be deemed to have been satisfied if such documents, records or information are retained in the electronic form, if:
   (*a*) the information contained therein remains accessible so as to be usable for a subsequent reference;
   (*b*) the electronic record is retained in the format in which it was originally generated, sent or received or in a format which can be demonstrated, to represent accurately the information originally generated, sent or received;
   (*c*) the details which will facilitate the identification of the origin, destination, date and time of despatch or receipt of such electronic record are available in the electronic record.

   However, the above rule does not apply to any information which is automatically generated solely for the purpose of enabling an electronic record to be despatched or received. Further, the Section shall not apply to any law that expressly provides for the retention of documents, records or information in the form of electronic records.

Legal requirement for retaining record is generally laid down for ac-counting and tax purposes.

5. **Publication of Rules, Regulations, etc., in Electronic Gazette** (Sec. 8). Where any law provides that any rule, regulation, order, bye-law, notification or any other matter shall be published in the Official Gazette, then, such requirement shall be deemed to have been satisfied if such rule, regulation, order, bye-law, notification or any other matter is published in the Official Gazette or electronic Gazette.

   Provided that where any rule, regulation, order, bye-law, notification or any other matter is published in the Official Gazette or Electronic Gazette, the date of publication shall be deemed to be the date of the Gazette which was first published in any form.

   Electronic Gazette means Official Gazette published in the electronic form [Sec. 2(l)(*s*)].

6. **No Right to insist that the Document should be accepted in Electronic Form** (Sec. 9). Sections 6, 7 and 8 shall not confer a right upon any person to insist that any Ministry or Department of the Central Government or the State Government or any authority or body established by or under any law or controlled or funded by the Central or State Government should accept, issue, create, retain and preserve any document in the form of electronic records or effect any monetary transaction in the electronic form.

7. **Central Government empowered to make Rules in respect of Digital Signature** (Sec. 10). The Central Government is empowered to make rules in respect of digital signature prescribing:

   (*a*) the type of digital signature;

   (*b*) the manner and format in which the digital signature shall be affixed;

   (*c*) the manner or procedure which facilitates identification of the person affixing the digital signature;

   (*d*) control processes and procedures to ensure adequate integrity, security and confidentiality of electronic records or payments; and

   (*e*) any other matter which is necessary to give legal effect to digital signatures.

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The Central Government has notified the 'Information Technology (Certifying Authorities) Rules, 2000. Rule 3 of these Rules provides the manner in which the information is to be authenticated by means of digital signature. Rule 4 provides the manner of creation of digital signature, and Rule 5 provides the manner of verification of digital signature.

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The IT Act, 2000 has defined the various expressions used above as follows:

Information [Sec. 2(l)(*v*)]. It includes data, text, images, sound, voice, codes, computer programmes, software and databases or micro film or computer generated micro fiche.

Electronic form [Sec. 2(1)(*r*)]. 'Electronic form,' with reference to information, means any information generated, sent, received or stored in media, magnetic, optical, computer memory, microfilm, computer generated micro fiche or similar device.

Accessibility or Access [Sec. 2(l)(*a*)]. It means gaining entry into, instructing or communicating with the logical, arithmetical or memory func-tion resources of a computer, computer system or computer network.

The various expressions used in the above definitions have been defined in the Act as follows:

Computer [Sec. 2(1)(*i*)]. It means any electronic, magnetic, optical or other high-speed data processing device or system which performs logi-cal, arithmetic, and memory functions by manipulations of electronic, magnetic or optical impulses, and includes all input, output, processing, storage, computer software, or communication facilities which are connected or related to the computer in a computer system or computer network.

Computer network [Sec. 2(l)(*j*)]. It means the interconnection of one or more computers through:

(*i*) the use of satellite, microwave, terrestrial line or other communica-tion media; and

(*ii*) terminals or a complex consisting of two or more interconnected computers whether or not the interconnection is continuously maintained.

Computer resource [Sec. 2(l)(*k*)]. It means computer, computer sys-tem, computer network, data, computer database or software.

Computer system [Sec. 2(1)(*I*)]. It means a device or collection of devices, including input and output support devices and excluding calcu-lators which are not programmable and capable of being used in conjunc-tion with external files, which contain computer programmes, electronic instructions, input data, and output data, that performs logic, arithmetic, data storage and retrieval, communication control and other functions.

Data [Sec. 2(1)(*o*)]. It means a representation of information, knowl-edge, facts, concepts or instructions which are being prepared or have been prepared in a formalised manner, and is intended to be processed, is being processed or has been processed in a computer system or computer network, and may be in any form (including computer printouts, magnetic or optical storage media, punched cards, punched tapes) or stored inter-nally in the memory of the computer.

Function [Sec. 2(1)(*u*)]. In relation to a computer, it includes logic, control, arithmetical process, deletion, storage and retrieval and commu-nication or telecommunication from or within a computer.

11.3.1 Regulation of Certifying Authorities

With a view to creating regulations for certification, the IT Act, 2000 provides for the appointment, functions, powers and duties of 'Controller of Certifying Authorities' and other officers. The procedure for issuing a licence to a 'Certifying Authority', as well as the procedure for suspen-sion or revocation or renewal of the licence has also been laid down. The Act also provides for the functions and duties of Certifying Authorities.

Appointment of Controller and other Officers (Sec. 17)

(1) The Central Government may, by notification in the Official Gazette, appoint a Controller of Certifying Authorities for the purposes of this Act and may also by the same or subsequent notification appoint such number of Deputy Controllers and Assistant Controllers as it deems fit.

(2) The Controller shall discharge his functions under this Act subject to the general control and directions of the Central Government.

(3) The Deputy Controllers and Assistant Controllers shall perform the functions assigned to them by the Controller under the general superintendence and control of the Controller.

(4) The qualifications, experience and terms and conditions of service of Controller, Deputy Controllers and Assistant Controllers shall be such as may be prescribed by the Central Government.

(5) The Head Office and Branch Office of the office of the Controller shall be at such places as the Central Government may specify, and these may be established at such places as the Central Government may think fit.

(6) There shall be a seal of the Office of the Controller.

Functions of Controller (Sec. 18)

The Controller may, perform all or any of the following functions, namely:

(*a*) exercising supervision over the activities of the Certifying Authorities;

(*b*) certifying public keys of the Certifying Authorities;

(*c*) laying down the standards to be maintained by the Certifying Authorities;

(*d*) specifying the qualifications and experience which employees of the Certifying Authorities should possess;

(*e*) specifying the conditions subject to which the Certifying Authori-ties shall conduct their business;

(*f*) specifying the contents of written, printed or visual materials and advertisements that may be distributed or used in respect of a Digital Signature Certificate and the public key;

(*g*) specifying the form and content of a Digital Signature Certificate and the key;

(*h*) specifying the form and manner in which accounts shall be main-tained by the Certifying Authorities;

(*i*) specifying the terms and conditions subject to which auditors may be appointed and the remuneration to be paid to them;

(*j*) facilitating the establishment of any electronic system by a Certi-fying Authority either solely or jointly with other Certifying Authorities and regulation of such systems;

(*k*) specifying the manner in which the Certifying Authorities shall conduct their dealings with the subscribers;

(*l*) resolving any conflict of interests between the Certifying Authori-ties and the subscribers;

(*m*) laying down the duties of the Certifying Authorities;

(*n*) maintaining a database containing the disclosure record of every Certifying Authority containing such particulars as may be specified by regulations which shall be accessible to public.

Recognition of Foreign Certifying Authorities (Sec. 19)

Subject to such conditions and restrictions as may be specified by regulations, the Controller may with the previous approval of the Central Government, and by notification in the Official Gazette, recognise any foreign Certifying Authority as a Certifying Authority for the purposes of this Act [Sec. 19(1)].

Where any Certifying Authority is recognised under sub-section (1), the Digital Signature Certificate issued by such Certifying Authority shall be valid for the purposes of the Act [Sec. 19(2)].

Revocation of recognition. The Controller may if he is satisfied that any Certifying Authority has contravened any of the conditions and restrictions subject to which it was granted recognition under sub-section (1) he may, for reasons to be recorded in writing, by notification in the Official Gazette, revoke such recognition [Sec. 19(3)].

Controller to Act as Repository (Sec. 20)

A 'repository' is an online database of Digital Signature Certificates and other related information useful for those who conduct their business operations through the medium of computer internet or *e*-commerce.

The Controller shall be the repository of all Digital Signature Certifi-cates issued under this Act [Sec. 20(1)].

To ensure that the secrecy and security of the digital signatures are assured the Controller shall:

(*a*) make use of hardware, software and procedures that are secure from intrusion and misuse;

(*b*) observe such other standards as may be prescribed by the Central Government [Sec. 20(2)].

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The Controller shall maintain a computerised database of all public keys in such a manner that such database and the public keys are avail-able to any member of the public [Sec. 20(3)].

Grant of Licence to Certifying Authorities to Issue

Digital Signature Certificates (Sec. 21)

Any person may make an application, to the Controller, for a licence to issue Digital Signature Certificate, provided he fulfils such requirements with respect to qualification, expertise, manpower, financial resources and other infrastructure facilities, which are necessary to issue Digital Signa-ture Certificates as may be prescribed by the Central Government [Sec. 21(1) (2)].

A licence granted under this Section shall:

(*a*) be valid for such period as may be prescribed by the Central Government;

(*b*) not be transferable or heritable;

(*c*) be subject to such terms and conditions as may be specified by the regulations [Sec. 21(3)].

Application for licence (Sec. 22). Every application for issue of a licence shall be in such form as may be prescribed by the Central Govern-ment. The application for issue of a licence shall be accompanied by:

(*a*) a certification practice statement;

(*b*) a statement including the procedures with respect to identification of the applicant;

(*c*) payment of such fees, not exceeding twenty-five thousand rupees as may be prescribed by the Central Government;

(*d*) such other documents, as may be prescribed by the Central Government.

Certification practice statement [Sec. 2(l)(*h*)]. 'It means a statement issued by a Certifying Authority to specify the practices that it employs in issuing Digital Signature Certificates.' This statement specifies a set of rules and requirements which are to be followed by a Certifying Authority (CA) in its operation and issuing certificates.

Procedure for grant or rejection of licence (Sec. 24). The Controller may, on receipt of an application for a licence to issue Digital Signature Certificate, after considering the documents accompanying the application and such other factors, as he deems fit, grant the licence or reject the application. However, no application shall be rejected under this Section unless the applicant has been given a reasonable opportunity of present-ing his case.

Renewal of licence (Sec. 23). An application for renewal of a licence shall be-:

(*a*) in such form;

(*b*) accompanied by such fees, not exceeding five thousand rupees, as may be prescribed by the Central Government and shall be made not less than forty-five days before the date of expiry of the period of validity of the licence.

Suspension of licence (Sec. 25). The Controller may, if he is satisfied after making an inquiry, revoke the licence where a Certifying Authority has,—

(*a*) made a statement in, or in relation to, the application for the issue or renewal of the licence, which is incorrect or false in material particulars;

(*b*) failed to comply with the terms and conditions subject to which the licence was granted;

(*c*) failed to maintain the procedures and standards specified in Section 30;

(*d*) contravened any provisions of this Act, rule, regulation or order made thereunder.

However, no licence shall be revoked unless the Certifying Authority has been given a reasonable opportunity of showing cause against the proposed revocation [Sec. 25(1)].

The Controller may, if he has reasonable cause to believe that there is any ground for revoking a licence under sub-section (1), by order suspend such licence pending the completion of any inquiry ordered by him. However, no licence shall be suspended for a period exceeding ten days unless the Certifying Authority has been given a reasonable oppor-tunity of showing cause against the proposed suspension [Sec. 25(2)]. Further, no Certifying Authority whose licence has been suspended shall issue any Digital Signature Certificate during such suspension [Sec. 25(3)].

Notice of suspension or revocation of licence (Sec. 26). Where the licence of the Certifying Authority is suspended or revoked, the Controller shall publish notice of such suspension or revocation, as the case may be, in the database maintained by him. Where one or more repositories are specified, the Controller shall publish notices of such suspension or re-vocation, as the case may be, in all such repositories. However, the da-tabase containing the notice of such suspension

or revocation, as the case may be, shall be made available through a website which shall be accessible round the clock.

11.3.2 Digital Signature Certificates

NOTES

The purpose of a digital signature certificate is to authenticate the identify of an individual. It ensures that the purported sender is infact the person who sent the message. It is signed digitally by the Certifying Authority.

Certifying Authority to Issue Digital Signature Certificate (Sec. 35)

Application. Any person may make an application to the Certifying Authority for the issue of a Digital Signature Certificate in such form as may be prescribed by the Central Government. The application shall be accompanied:

(*a*) by such fee not exceeding twenty-five thousand rupees as may be prescribed by the Central Government. However, different fees may be prescribed for different classes of applicants.

(*b*) by a 'certification practice statement' or where there is no such statement, a statement containing such particulars, as may be specified by regulations.

Grant of certificate. On receipt of an application for the issue of Digital Signature Certificate, the Certifying Authority may, after consider-ation of the 'certification practice statement' or the other statement re-ferred above and after making such enquiries as it may deem fit, grant the Digital Signature Certificate or for reasons to be recorded in writing, reject the application. However, no Digital Signature Certificate shall be granted unless the Certifying Authority is satisfied that:

(*a*) the applicant holds the private key corresponding to the public key to be listed in the Digital Signature Certificate;

(*b*) the applicant holds a private key, which is capable of creating a digital signature;

(*c*) the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the applicant.

Representations upon issuance of Digital Signature Certificate (Sec. 36)

While issuing a Digital Signature Certificate, the Certifying Authority certifies that, the information contained in it is accurate and that:

(*a*) it has complied with the provisions of this Act and the rules and regulations made thereunder;

(*b*) it has published the Digital Signature Certificate or otherwise made it available to such person relying on it and the subscriber has accepted it;

(*c*) the subscriber holds the private key corresponding to the public key, listed in the Digital Signature Certificate;

(*d*) the subscriber's public key and private key constitute a function-ing key pair; and

(*e*) it has no knowledge of any material fact, which if it had been included in the Digital Signature Certificate would adversely affect the reliability of the representations made in clauses (*a*) to (*d*).

Suspension of Digital Signature Certificate (Sec. 37)

The Certifying Authority which has issued a Digital Signature Certifi-cate may suspend such Digital Signature Certificate:

(*a*) on receipt of a request to that effect from:

(*i*) the subscriber listed in the Digital Signature Certificate; or

(*ii*) any person duly authorised to act on behalf of that sub-scriber;

(*b*) if it is of opinion that the Digital Signature Certificate should be suspended in public interest.

A Digital Signature Certificate shall not be suspended for a period exceeding fifteen days unless that subscriber has been given an oppor-tunity of being heard in the matter. Further, on suspension of a Digital Signature Certificate under this Section, the Certifying Authority shall communicate the same to the subscriber.

Revocation of Digital Signature Certificate (Sec. 38)

A Certifying Authority may revoke a Digital Signature Certificate issued by it:

(*a*) where the subscriber or any other person authorised by him makes a request to that effect; or

(*b*) upon the death of the subscriber; or

(*c*) upon the dissolution of the firm or winding up of the company where the subscriber is a firm or a company.

The Certifying Authority may also revoke a Digital Signature Certifi-cate which has been issued by it at any time, if it is of opinion that:

(*a*) a material fact represented in the Digital Signature Certificate is false or has been concealed;

(*b*) a requirement for issuance of the Digital Signature Certificate was not satisfied;

(*c*) the Certifying Authority's private key or security system was compromised in a manner materially affecting the Digital Signature Certificate's reliability;

(*d*) the subscriber has been declared insolvent or dead or where a subscriber is a firm or a company, which has been dissolved, wound-up or otherwise ceased to exist.

A Digital Signature Certificate shall not be revoked unless the sub-scriber has been given an opportunity of being heard in the matter. Fur-ther, on revocation

of a Digital Signature Certificate under this Section, the Certifying Authority shall communicate the same to the subscriber.

Notice of suspension or revocation (Sec. 39). Where a Digital Signa-ture Certificate is suspended or revoked under Section 37 or Section 38, the Certifying Authority shall publish a notice of such suspension or revocation, as the case may be, in the repository specified in the Digital Signature Certificate for publication of such notice. Where one or more repositories are specified, the Certifying Authority shall publish notices of such suspension or revocation, as the case may be, in all such repositories.

11.3.3 Penalties and Adjudication

Inspite of security measures adopted by an owner of the computer, com-puter system and computer network, there are theft and intrusion. Legal protection has therefore been provided against the wrongdoers. Under the Act penalty is imposed by way of damages to be paid as compensation to the affected party for damage caused to any computer, computer net-work etc. by introduction of computer virus, unauthorised access and other types of mischief.

Penalty for Damage to Computer, Computer System, etc. (Sec. 43)

If any person indulges in any of the following acts, without permis-sion of the owner or any other person who is incharge of a computer, computer system or computer network, he shall be liable to pay damages by way of compensation not exceeding one crore rupees to the person so affected:

(*a*) accesses or secures access to such computer, computer system or computer network;

(*b*) downloads, copies or extracts any data, computer database or information from such computer, computer system or computer network including information or data held or stored in any removable storage medium;

(*c*) introduces or causes to be introduced any computer contaminant or computer virus into any computer, computer system or computer net-work;

(*d*) damages or causes to be damaged any computer, computer system or computer network, data, computer database or any other programmes residing in such computer, computer system or computer network;

(*e*) disrupts or causes disruption of any computer, computer system or computer network;

(*f*) denies or causes the denial of access to any person authorised to access any computer, computer system or computer network by any means;

(*g*) provides any assistance to any person to facilitate access to a computer, computer system or computer network in contravention of the provisions of this Act, rules or regulations made thereunder;

(*h*) charges the services availed of by a person to the account of another person by tampering with or manipulating any computer, computer system, or computer network.

Explanation—For the purposes of this Section:

(*i*) *'computer contaminant'* means any set of computer instructions that are designed:

(*a*) to modify, destroy, record, transmit data or programme residing within a computer, computer system or computer network; or

(*b*) by any means to usurp the normal operation of the computer, computer system, or computer network;

(*ii*) *'computer database'* means a representation of information, knowl-edge, facts, concepts or instructions in text, image, audio, video that are being prepared or have been prepared in a formalised manner or have been produced by a computer, computer system or computer network and are intended for use in a computer, computer system or computer network;

(*iii*) *'computer virus'* means any computer instruction, information, data or programme that destroys, damages, degrades or adversely affects the performance of a computer resource or attaches itself to another computer resource and operates when a programme, data or instruction is executed or some other event takes place in that computer resource;

(*iv*) *'damage'* means to destroy, alter, delete, add, modify or rearrange any computer resource by any means.

Penalty for Failure to Furnish Information, Return, etc. (Sec. 44)

If any person who is required under this Act or any rules or regula-tions made thereunder to:

(*a*) furnish any document, return or report to the Controller or the Certifying Authority fails to furnish the same, he shall be liable to a penalty not exceeding one lakh and fifty thousand rupees for each such failure;

(*b*) file any return or furnish any information, books or other docu-ments within the time specified therefor in the regulations fails to file return or furnish the same within the time specified therefor in the regu-lations, he shall be liable to a penalty not exceeding five thousand rupees for every day during which such failure continues;

(*c*) maintain books of account or records fails to maintain the same, he shall be liable to a penalty not exceeding ten thousand rupees for every day during which the failure continues.

Penalty where no Specific Penalty is Provided Elsewhere in the Act (Sec. 45)

Whoever contravenes any rules or regulations made under this Act, for the contravention of which no penalty has been separately provided, shall be liable to

pay a compensation not exceeding twenty-five thousand rupees to the person affected by such contravention or a penalty not exceeding twenty five thousand rupees.

Adjudication — Appointment of Adjudicating Officer (Sec. 46)

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For the purpose of adjudging whether any person has committed a contravention of any of the provisions of this Act or of any rule, regu-lation, direction or order made thereunder the Central Government shall appoint any officer not below the rank of a Director to the Government of India or an equivalent officer of a State Government to be an Adjudicating Officer for holding an inquiry in the manner prescribed by the Central Government. However, no person shall be appointed as an Adjudicating Officer unless he possesses such experience in the field of Information Technology and legal or judicial experience as may be prescribed by the Central Government.

The Adjudicating Officer shall, after giving the person referred to above, give a reasonable opportunity for making representation in the matter and if, on such inquiry, he is satisfied that the person has commit-ted the contravention, he may impose such penalty or award such com-pensation as he thinks fit in accordance with the provisions of that Sec-tion.

Where more than one Adjudicating Officers are appointed, the Central Government shall specify by order the matters and places with respect to which such officers shall exercise their jurisdiction.

Powers. Every Adjudicating Officer shall have the powers of a civil court which are conferred on the Cyber Appellate Tribunal under sub--section (2) of Section 58, and:

(*a*) all proceedings before it shall be deemed to be judicial proceedings within the meaning of Sections 193 and 228 of the Indian Penal Code, 1860;

(*b*) shall be deemed to be civil court for the purposes of Sections 345 and 346 of the Code of Criminal Procedure, 1973.

Factors to be taken into account by the Adjudicating Officer (Sec. 47). While adjudging the quantum of compensation, the Adjudicating Officer shall have due regard to the following factors, namely:

(*a*) the amount of gain of unfair advantage, wherever quantifiable, made as a result of the default;

(*b*) the amount of loss caused to any person as a result of the default;

(*c*) the repetitive nature of the default.

11.3.4 Cyber Laws

Here the IT Act, 2000 deals with the establishment of one or more Appellate Tribunals to be known as Cyber Regulations Appellate Tribunal or Cyber Appellate Tribunal to exercise jurisdiction, powers and authority as conferred under the Act.

Establishment of Cyber Appellate Tribunal (Sec. 48)

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The Central Government shall, by notification, establish one or more appellate tribunals to be known as the Cyber Regulations Appellate Tri-bunal. It shall also specify, in the notification the matters and places in relation to which the Cyber Appellate Tribunal may exercise jurisdiction.

Composition of Cyber Appellate Tribunal (Sec. 49). A Cyber Appel-late Tribunal shall consist of one person only (hereinafter referred to as the Presiding Officer of the Cyber Appellate Tribunal) to be appointed, by notification, by the Central Government.

Orders constituting Appellate Tribunal to be final and not to invalidate its proceedings (Sec. 55). No order of the Central Government ap-pointing any person as the Presiding Officer of a Cyber Appellate Tribunal shall be called in question in any manner and no act or proceeding before a Cyber Appellate Tribunal shall be called in question in any manner on the ground merely of any defect in the constitution of a Cyber Appellate Tribunal.

Staff of the Cyber Appellate Tribunal (Sec. 56). The Central Govern-ment shall provide the Cyber Appellate Tribunal with such officers and employees as that Government may think fit. The officers and employees of the Cyber Appellate Tribunal shall discharge their functions under general superintendence of the Presiding Officer. The salaries and allow-ances and other conditions of service of the officers and employees of the Cyber Appellate Tribunal shall be such as may be prescribed by the Central Government.

Qualifications for appointment as Presiding Officer of the Cyber Appellate Tribunal (Sec. 50). A person shall not be qualified for appoint-ment as the Presiding Officer of a Cyber Appellate Tribunal unless he:

(*a*) is, or has been, or is qualified to be, a Judge of a High Court; or

(*b*) is, or has been a member of the Indian Legal Service and is holding, or has held a post in Grade I of the Service for at least three years.

Term of office (Sec. 51). The Presiding officer of a Cyber Appellate Tribunal shall hold office for a term of five years from the date on which he enters upon his office or until he attains the age of sixty-five years, whichever is earlier.

Salary, allowances and other terms and conditions of service of Presiding Officer (Sec. 52). The salary and allowances payable to, and the other terms and conditions of service including pension, gratuity and other retirement benefits of, the Presiding Officer of a Cyber Appellate Tribunal shall be such as may be prescribed. Further, the salary and allowances and the other terms and conditions of service of the Presiding Officer shall not be varied to his disadvantage after appointment.

Filling up of vacancies (Sec. 53). If, for reason other than temporary absence, any vacancy occurs in the office of the Presiding Officer of a Cyber Appellate Tribunal, then the Central Government shall appoint another person in

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accordance with the provisions of this Act to fill the vacancy and the proceedings may be continued before the Cyber Appellate Tribu-nal from the stage at which the vacancy is filled.

Resignation [Sec. 54(1)]. The Presiding Officer of Cyber Appellate Tribunal may, be notice in writing under his hand addressed to the Central Government, resign his office. However, he shall, unless he is permitted by the Central Government to relinquish his office sooner, continue to hold office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as his successor enters upon his office or until the expiry of his term of office, whichever is the earliest.

Removal [Sec. 54(2)(3)]. The Presiding Officer of a Cyber Appellate Tribunal shall not be removed from his office except by an order by the Central Government on the ground of proved misbehaviour or incapacity after an inquiry made by a Judge of the Supreme Court in which the Presiding Officer concerned has been informed of the charges against him and given a reasonable opportunity of being heard in respect of these charges. The Central Government may, by rules, regulate the procedure for the investigation of misbehaviour or incapacity of the aforesaid Presiding Officer.

Appeal to Cyber Regulations Appellate Tribunal (Sec. 57)

Any person aggrieved by an order made by Controller or an Adjudicating Officer under this Act may prefer an appeal to a Cyber Appellate Tribunal having jurisdiction in the matter. However, no appeal shall lie from an order made by an Adjudicating Officer with the consent of the parties.

Period allowed for appeal. Every appeal shall be filed within a period of forty-five days from the date on which a copy of the order made by the Controller or the Adjudicating Officer is received by the person aggrieved and it shall be in such form and be accompanied by such fee as may be prescribed. However, the Cyber Appellate Tribunal may entertain an ap-peal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

Order by Cyber Appellate Tribunal. On receipt of an appeal, the Cyber Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against. The appeal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within six months from the date of receipt of the appeal. The Cyber Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Controller or Adjudicating Officer.

The appellant may either appear in person or authorise one or more legal practitioners or any of its officers to present his or its case before the Cyber Appellate Tribunal (Sec. 59).

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Powers of the Cyber Appellate Tribunal (Sec. 58)

The Cyber Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908. It shall, however, be guided by the principles of natural justice, provisions of the Act and rules made thereunder. Natural justice means to act in good faith, fairly, justly and impartially and never arbitrarily. It shall have powers to regulate its own procedure including the place at which it shall have its sittings.

The Cyber Appellate Tribunal shall have, for the purposes of dis-charging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:

(*a*) summoning and enforcing the attendance of any person and exam-ining him on oath;

(*b*) requiring the discovery and production of documents or other electronic records;

(*c*) receiving evidence on affidavits;

(*d*) issuing commissions for the examination of witnesses or docu-ments;

(*e*) reviewing its decisions;

(*f*) dismissing an application for default or deciding it *ex parte;*

(*g*) any other matter which may be prescribed.

Every proceeding before the Cyber Appellate Tribunal shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purposes of Section 196 of the Indian Penal Code and the Cyber Appellate Tribunal shall be deemed to be a civil court for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Pro-cedure, 1973.

The Central Government has notified the 'Cyber Regulations Appel-late Tribunal (Procedure) Rules, 2000.'

Civil Court not to have Jurisdiction (Sec. 61)

The Adjudicating Officer and the Cyber Appellate Tribunal have ex-clusive jurisdiction to decide specific issues for which they have been empowered. Section 61 provides that:

(*a*) No court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Officer appointed under this Act or the Cyber Appellate Tribunal constituted under this Act is empowered by or under this Act to determine; and

(*b*) No injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act. Injunction is a specific order of the court directing the defendant to refrain from doing certain act.

Appeal to High Court (Sec. 62)

Any person aggrieved by any decision or order of the Cyber Appel-late Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Cyber Appellate Tribunal to him on any question of fact or law arising out of such order. However, the High Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days.

Check Your Progress

1. What do you understand by the term e-governance?
2. What do you understand by the term digital signature?
3. State two duties of the certifying authority.

11.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. The term 'e-governance' or electronic governance refers to the application of information technology to the processes of Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) governance. It involves electronic filing of documents with the government agencies and creating a network of e-services and e-administration. Electronic Governance (e-governance) is fast catching up and more and more government processes are going on-line resulting in less bureaucracy, more transparency and openness. Companies will be able to file any form, application or any other document in the electronic form and get Licenses/Certificates on-line.
2. Digital signatures are the electronic equivalent of the handwritten signatures. In an electronic message or transaction affixing handwritten signature is not possible. Authentication of the record has to be achieved by some electronic or digital method. 'Affixing digital signature' has been defined in Section 2(l)(d) of the Act to mean adoption of any methodology or procedure by a person for the purpose of authenticating an electronic record by means of 'digital signature'.
3. The two duties of the certifying authority are as follows:
   (a) To ensure that every person employed or otherwise engaged by it complies, in the course of his employment or engagement, with the provisions of the Act, rules, regulations and orders made thereunder (Sec. 31).
   (b) To display its licence at a conspicuous place of the premises in which it carries on its business (Sec. 32).

11.5 SUMMARY

- The law relating to 'information technology' is contained in the In-formation Technology (IT) Act, 2000, which came into force on 17th October, 2000. It is the first Cyber Law in India.
- The Information Technology (IT) Act, 2000 has been designed to give boost to Electronic Commerce (e-commerce), e-transactions and similar activities associated with commerce and trade, and also to facilitate Elec-tronic Governance (e-governance) by means of reliable electronic records.
- The Information Technology Act, 2000 consists of 13 Chapters di-vided into 94 Sections. Chapters I to VIII are mostly digital signature related. Chapters IX to XIII are regarding penalties, offences, etc. The Act has four Schedules on consequential amendments in respect of certain other Acts.
- The Law of Information Technology recognises the digital signature so that the Internet contract is authenticated and becomes binding on the parties. These are the electronic equivalent of the handwritten signatures.
- The term Electronic Governance refers to the application of informa-tion technology to the processes of Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) governance.
- In view of the fact that the communicated electronic records and messages must be secure and reliable for giving boost to *e*-commerce, the IT Act, 2000 lays down the legal presumptions as to when the 'electronic record' and 'digital signature' are deemed secure.
- A 'repository' is an online database of Digital Signature Certificates and other related information useful for those who conduct their business operations through the medium of computer internet or *e*-commerce.
- Under the Act penalty is imposed by way of damages to be paid as compensation to the affected party for damage caused to any computer, computer net-work etc. by introduction of computer virus, unauthorised access and other types of mischief.

11.6 KEY WORDS

- **Electronic Commerce:** Electronic commerce (ecommerce) is a type of business model, or segment of a larger business model, that enables a firm or individual to conduct business over an electronic network, typically the Internet.

- **Digital Signature:** It refers to a digital code (generated and authenticated by public key encryption) which is attached to an electronically transmitted document to verify its contents and the sender's identity.
- **Electronic Records:** It refers to information captured through electronic means, and which may or may not have a paper record to back it up. Also called machine readable record.
- **Adjudication:** It refers to a formal judgement on a disputed matter.

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11.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. What do you understand by the term Information Technology?
2. Discuss the terms 'e-commerce' and 'e-governance' with reference to Information Technology Act, 2000.
3. What are the objectives of cyber laws?

Long-Answer Questions

1. Discuss the powers of 'Controller of Certifying Authorities' under the Information Technology Act, 2000.
2. Discuss the duties of 'Certifying Authority' under the Information Technology Act, 2000.
3. Discuss the provisions of Information Technology Act, 2000 relating to 'Digital Signature Certificate'.
4. How is 'Cyber Appellate Tribunal' established? What are its powers under the Information Technology Act, 2000? Discuss.
5. Discuss the provisions of Information Technology Act, 2000 relating to appointment, term of office, salary, resignation and removal of the Chairperson of the Cyber Appellate Tribunal.

11.8 FURTHER READINGS

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BLOCK - IV
MSME

UNIT 12 MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT, 2006

Structure

12.0 INTRODUCTION

Micro, small and medium enterprises (MSMEs) have a very important role in developing the Indian economy. They help reduce poverty by creating jobs for the country's growing labour force. They stimulate economic development in rural and far-flung areas. Often rightly termed as 'the engine of growth' for India, MSME has played a prominent role in the development of the country in terms of creating employment opportunities. MSME has employed more than 50 million people, scaling manufacturing capabilities, curtailing regional disparities, balancing the distribution of wealth, and contributing to the GDP. MSME sector forms 8 per cent of GDP. Though India is still facing infrastructural problems, lack of proper market linkages, and challenges in terms of flow of institutional credit, it has seen a tremendous growth in this sector.

In view of the ever growing importance of the MSME sector, the Indian Parliament enacted the Micro, Small and Medium Enterprises (MSME) Act in 2006 to provide for facilitating the promotion and development and enhancing the competitiveness of MSME and for matters connected therewith or incidental thereto. With the introduction of the MSME Act, service sector has been included in the definition of MSME, which is a historic development.

12.1 OBJECTIVES

After going through this unit, you will be able to:

- Classify various enterprises into micro, small and medium enterprises
- Discuss the salient features of the Micro, Small and Medium Enterprises (MSME) Act , 2006

12.2 SALIENT FEATURES OF MICRO, SMALL AND MEDIUM ENTERPRISES ACT, 2006

A single comprehensive act for development and regulation of small enterprises had been a long outstanding demand of the Sector so as to free it from a plethora of laws and regulations and visit of inspectors, which it had to face with limited awareness and resources. The need has been emphasized from time to time by stake holders at different fora. In addition, recommendations to provide for a proper legal framework for small sector to relieve it of the requirements to comply with multiple rules and regulations were made by the Committees such as the Abid Hussain Committee (1997) and Study Group under Dr. S.P. Gupta (2000).

While the small scale industries continued to be important for the economy, in the recent years the small scale services have also emerged as a significant sector contributing substantially to the economy and employing millions of workers. Therefore, it became necessary, as is the practice worldwide, to address the concerns of both the small scale industries and services together and recognize them as small enterprises. The worldwide as a composite sector. In a fast growing economy like ours, the natural mobility of small enterprises to medium ones has to be facilitated through appropriate policy interventions and legal framework. With these objectives in view, the Government came with an exclusive legislation for micro, small and medium enterprises known as the Micro, Small and Medium Enterprises Development Act, 2006.

12.2.1 Classification of Micro, Small and Medium Enterprises

According to the MSME Act:

(*a*) In the case of the enterprises engaged in the **manufacture or production of goods** pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, an enterprise is:

(*i*) a micro enterprise, where the investment in plant and machinery does not exceed twenty- five lakh rupees;

(*ii*) a small enterprise, where the investment in plant and machinery is more than twenty-five lakh rupees but does not exceed five crore rupees; or

(*iii*) a medium enterprise, where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees;

(*b*) In the case of the enterprises engaged in **providing or rendering of services**, an enterprise is:

(*i*) a micro enterprise, where the investment in equipment does not exceed ten lakh rupees;

(*ii*) a small enterprise, where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees; or

(*iii*) a medium enterprise, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

12.2.2 Advisory Committee

The Central Government shall, by notification, constitute an Advisory Committee consisting of the following members, namely:—

(*a*) the Secretary to the Government of India in the Ministry or Department of the Central Government having administrative control of the small and medium enterprises who shall be the Chairperson, *ex officio*;

(*b*) not more than five officers of the Central Government possessing necessary expertise in matters relating to micro, small and medium enterprises, members, *ex officio*;

(*c*) not more than three representatives of the State Governments, members, *ex officio*; and

(*d*) one representative each of the associations of micro, small and medium enterprises, members, *ex officio*.

The Member-Secretary of the Board shall also be the *ex officio* Member-Secretary of the Advisory Committee. The Central Government shall, prior to classifying any class or classes of enterprises, obtain the recommendations of the Advisory Committee. The Advisory Committee shall examine the matters referred to it by the Board and furnish its recommendations to the Board. The Advisory Committee shall, after considering the following matters, communicate its recommendations or advice to the Central Government or, as the case may be, State Government or the Board, namely:—

(*a*) the level of employment in a class or classes of enterprises;

(*b*) the level of investments in plant and machinery or equipment in a class or classes of enterprises;

(*c*) the need of higher investment in plant and machinery or equipment for technological upgradation, employment generation and enhanced competitiveness of the class or classes of enterprises;

(*d*) the possibility of promoting and diffusing entrepreneurship inmicro, small or medium enterprises; and

(*e*) the international standards for classification of small and medium enterprises.

12.2.3 Memorandum of Micro, Small and Medium enterprises

Any person who intends to establish,—

(*a*) a micro or small enterprise, may, at his discretion; or

(*b*) a medium enterprise engaged in providing or rendering of services may, at his discretion; or

(*c*) a medium enterprise engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, shall file the memorandum of micro, small or, as the case may be, of medium enterprise with such authority as may be specified by the State or the Central Government,

Provided that any person who, before the commencement of this Act, established—

(*a*) a small scale industry and obtained a registration certificate, may, at his discretion; and

(*b*) an industry engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 ,having investment in plant and machinery of more than one crore rupees but not exceeding ten crore rupees and, in pursuance of the notification of the Government of India in the erstwhile Ministry of Industry (Department of Industrial Development), shall within one hundred and eighty days from the commencement of this Act, file the memorandum, in accordance with the provisions of this Act.

The form of the memorandum, the procedure of its filing and other matters incidental thereto shall be such as may be notified by the Central Government after obtaining the recommendations of the Advisory Committee in this behalf. The authority with which the memorandum shall be filed by a medium enterprise shall be such as may be specified, by notification, by the Central Government. The State Government shall, by notification, specify the authority with which a micro or small enterprise may file the memorandum.

12.2.4 Measures for Promotion, Development and Enhancement of Competitiveness of MSME

- **Measures for promotion and development:** The Central Government may, from time to time, for the purposes of facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises, particularly of the micro and small enterprises, by way of development of skill in the employees, management and entrepreneurs, provisioning for technological upgradation, marketing assistance or infrastructure facilities and cluster development of such enterprises with a view to strengthening backward and forward linkages, specify, by notification, such programmes, guidelines or instructions, as it may deem fit.

- **Credit facilities:** The policies and practices in respect of credit to the micro, small and medium enterprises shall be progressive and such as may be specified in the guidelines or instructions issued by the Reserve Bank, from time to time, to ensure timely and smooth flow of credit to such enterprises, minimise the incidence of sickness among and enhance the competitiveness of such enterprises.
- **Procurement preference policy:** For facilitating promotion and development of micro and small enterprises, the Central Government or the State Government may, by order notify from time to time, preference policies in respect of procurement of goods and services, produced and provided by micro and small enterprises, by its Ministries or departments, as the case may be, or its aided institutions and public sector enterprises.
- **Funds:** There shall be constituted, by notification, one or more Funds to be called by such name as may be specified in the notification and there shall be credited thereto any grants made by the Central Government.
- **Grants by Central Government:** The Central Government may, after due appropriation made by Parliament by law in this behalf, credit to the Fund or Funds by way of grants for the purposes of this Act, such sums of money as that Government may consider necessary to provide.

12.2.5 Establishment of Micro and Small Enterprises Facilitation Council

The State Government shall, by notification, establish one or more Micro and Small Enterprises Facilitation Councils, at such places, exercising such jurisdiction and for such areas, as may be specified in the notification.

The Micro and Small Enterprise Facilitation Council shall consist of not less than three but not more than five members to be appointed from amongst the following categories, namely:—

(*i*) Director of Industries, by whatever name called, or any other officer not below the rank of such Director, in the Department of the State Government having administrative control of the small scale industries or, as the case may be, micro, small and medium enterprises; and

(*ii*) one or more office-bearers or representatives of associations of micro or small industry or enterprises in the State; and

(*iii*) one or more representatives of banks and financial institutions lending to micro or small enterprises; or

(*iv*) one or more persons having special knowledge in the field of industry, finance, law, trade or commerce.

The person appointed under clause (*i*) of sub-section (*1*) shall be the Chairperson of the Micro and Small Enterprises Facilitation Council. The composition of the Council, the manner of filling vacancies of its members and the procedure to be followed in the discharge of their functions by the members shall be such as may be prescribed by the State Government.

Check Your Progress

1. Which is a micro manufacturing enterprise as per the MSME Act?
2. Which is a small service enterprise as per the MSME Act?
3. Who is the Chairperson of the Advisory Committee constituted under the MSME Act?
4. How many persons can be elected for the Micro and Small Enterprise Facilitation Council?

12.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. As per the MSME Act, a manufacturing enterprise where the investment in plant and machinery does not exceed twenty- five lakh rupees is a micro enterprise.
2. As per the MSME Act, a service enterprise where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees is a small enterprise.
3. The Secretary to the Government of India in the Ministry or Department of the Central Government having administrative control of the small and medium enterprises is the Chairperson, ex officio, of the Advisory Committee.
4. The Micro and Small Enterprise Facilitation Council shall consist of not less than three but not more than five members.

12.4 SUMMARY

- In the case of the enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, an enterprise is a micro enterprise, where the investment in plant and machinery does not exceed twenty- five lakh rupees.
- In the case of the enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, an enterprise is a small enterprise, if the investment in plant and machinery is more than twenty-five lakh rupees but does not exceed five crore rupees.
- In the case of the enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951, an enterprise is a medium enterprise, if the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees.

- In the case of the enterprises engaged in providing or rendering of services, an enterprise is a micro enterprise, if the investment in equipment does not exceed ten lakh rupees.
- In the case of the enterprises engaged in providing or rendering of services, an enterprise is a small enterprise, if the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees.
- In the case of the enterprises engaged in providing or rendering of services, an enterprise is a medium enterprise, where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.
- The form of the memorandum of MSME, the procedure of its filing and other matters incidental thereto shall be such as may be notified by the Central Government after obtaining the recommendations of the Advisory Committee in this behalf.
- The policies and practices in respect of credit to the micro, small and medium enterprises shall be progressive and such as may be specified in the guidelines or instructions issued by the Reserve Bank, from time to time, to ensure timely and smooth flow of credit to such enterprises, minimise the incidence of sickness among and enhance the competitiveness of such enterprises.
- The Central Government may, from time to time, for the purposes of facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises, particularly of the micro and small enterprises, by way of development of skill in the employees, management and entrepreneurs, provisioning for technological upgradation, marketing assistance or infrastructure facilities and cluster development of such enterprises with a view to strengthening backward and forward linkages, specify, by notification, such programmes, guidelines or instructions, as it may deem fit.

12.5 KEY WORDS

- **Buyer:** It refers to who buys any goods or receives any services from a supplier for consideration.
- **Enterprise:** It refers to an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 or engaged in providing or rendering of any service or services.
- **Goods:** It refers to every kind of movable property other than actionable claims and money.

NOTES

12.6 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. How are enterprises engaged in the manufacture or production of goods classified into micro, small and medium enterprises?
2. How are enterprises engaged in providing or rendering services classified into micro, small and medium enterprises?
3. Write a note on constitution and composition of the Micro and Small Enterprises Facilitation Council.

Long-Answer Questions

1. Describe the measures provided in the MSME Act for promotion, development and enhancement of competitiveness of MSME.
2. Write notes on: (i) Memorandum of Micro, Small and Medium enterprises and (ii) Reservation Policy for MSME.

12.7 FURTHER READINGS

Kuchhal, M.C. and Vivek Kuchhal. 2013. *Business Law,* sixth edition. Delhi: Vikas Publishing House.

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UNIT 13 SALIENT FEATURES OF THE MSME ACT

NOTES

Structure

13.0 INTRODUCTION

In the previous unit, you were introduced to the Micro, Small and Medium Enterprises Development Act, 2006. In it, you learnt how the government classifies micro, small and medium enterprises. In this unit, the discussion on the MSME Act will continue. The unit will discuss reservation policy, credit policy, as well as government policy towards taxation and incentives.

13.1 OBJECTIVES

After going through this unit, you will be able to:

- Describe the government reservation, credit and taxation policies relating to MSME
- List the government's incentives for the promotion of the MSME sector

13.2 RESERVATION POLICY, CREDIT POLICY, GOVERNMENT POLICY TOWARDS TAXATION AND INCENTIVES

In this section, you will learn about government’s reservation, credit, taxation and incentive policies for the promotion of the MSME sector.

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13.2.1 Reservation Policy

An Advisory Committee constituted under the Industries (Development & Regulation) Act, 1951 on de-reservation periodically evaluates products /items reserved for exclusive production by MSME. India has opened up its economy since 1991 through a forward looking policy which led to de-licensing of items. Over the years list of items reserved for manufacture by MSME Sector has been reduced from over 800 to 20. On the recommendation of Advisory Committee, Government of India decided in 2015 to deserve remaining twenty items presently reserved for exclusive manufacture by MSME Sector. Accordingly following items are de-reserved:-

(i) Pickles and Chutneys, (ii) Bread, (iii) Mustard Oil (except solvent extracted), (iv) Ground Nut Oil (except solvent extracted), (v) Wooden furniture and Fixtures, (vi) Exercise Books and Registers, (vii) Wax Candles, (viii) Laundry Soap, (ix) Safety Matches, (x) Fire works, (xi) Agarbatties, (xii) Glass Bangles, (xiii) Steel Almirah, (xiv) Rolling shutters, (xv) Steel chairs – all types, (xvi) Steel tables – all other types, (xvii) Steel Furniture – all other types, (xviii) Padlocks, (xix) Stainless steel utensils, (xx) Domestic utensils – Aluminium.

The above policy initiatives have been taken to encourage greater investment, including the existing MSME units, to incorporate better technologies, standard and branch building to enhance competition in Indian and global markets for these products.

13.2.2 Credit Policy

Bank's lending to the Micro and Small enterprises engaged in the manufacture or production of goods specified in the first schedule to the Industries (Development and regulation) Act, 1951 and notified by the Government from time to time is reckoned for priority sector advances. However, bank loans up to ₹.5 crore per borrower / unit to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSMED Act, 2006 are eligible to be reckoned for priority sector advances. Lending to Medium enterprises is not eligible to be included for the purpose of computation of priority sector lending. Priority sector lending include only those sectors, as part of the priority sector that impact large sections of the population, the weaker sections and the sectors which are employment-intensive such as agriculture, and Micro and Small enterprises.

As per extant policy, certain targets have been prescribed for banks for lending to the Micro and Small enterprise (MSE) sector. In terms of the recommendations of the Prime Minister's Task Force on MSMEs banks have been advised to achieve a 20 per cent year-on-year growth in credit to micro and small enterprises, a 10 per cent annual growth in the number of micro enterprise accounts and 60% of total lending to MSE sector as on preceding March 31st to Micro enterprises.

In order to ensure that sufficient credit is available to micro enterprises within the MSE sector, banks should ensure that:

- 40 per cent of the total advances to MSE sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to ₹ 10 lakh and micro (service) enterprises having investment in equipment up to ₹ 4 lakh.
- 20 per cent of the total advances to MSE sector should go to micro (manufacturing) enterprises with investment in plant and machinery above ₹ 10 lakh and up to ₹ 25 lakh, and micro (service) enterprises with investment in equipment above ₹ 4 lakh and up to ₹ 10 lakh.

  Thus, 60 per cent of MSE advances should go to the micro enterprises.

13.2.3 Taxation

One of the best and easiest ways of providing assistance to MSMEs is through tax-related benefits. With the presentation of the budget in 2018, the government made clear its intention towards the MSME sector.

- Benefiting nearly 96% of the companies, the 5% reduction in corporate tax rates from 30% to 25% for domestic SMEs with an annual turnover of ₹ 50 crores in the year 2015-16, was aimed not only at providing tax relief to companies, but also at incentivising partnerships firms to move to the structured form of business by transforming into limited companies.
- By listing on the SME exchange, SME companies benefit from easier access to capital and equity finance, and higher visibility while enjoying tax benefits such as 0% long-term capital gains tax and 15% short-term gain tax.
- The timeframe for carrying forward MAT (minimum alternate tax) was raised to 15 years from 10 years, helping business enterprises to further reduce their tax liability in the future.
- Reduction in presumptive tax by 2% for companies with a turnover of up to ₹ 2 crores reduced the financial burden on them.

Benefits of GST for SMEs

Implementation of GST, though considered cumbersome and tedious by most SMEs, will actually benefit them in the longer run. The replacement of multiple taxes by a single, uniform one not only removes the cascading effect of multiple taxes but also makes it easier to administer and comply with.

- GST allows SMEs opportunities to access a wider market country-wide, bringing both out-of-state player and local seller on par through a seamless flow of tax credits.
- Ease of business is enabled by the application of the unified GST, which has replaced the multiple taxes levied at different by different authorities.

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- GST improves profitability by widening the scope of input credits to include services also.
- It also makes compliance easier through a reduction in the number of returns and switchover to the online regime. Businesses with turnover less than ₹ 20 lakhs can have multi-state operations without the need for GSTN registration. Also when turnover is less than ₹ 1.5 crores, only quarterly returns need to be filed.
- The limit for the composition scheme has been raised to ₹ 1.5 crores. Though subject to some restrictions, the scheme is highly beneficial for local businesses that do not deal in restricted products or sell in other states.

While GST may require an initial investment in technology and putting in place procedures to ensure compliance, GST, in the long run, is expected to be highly beneficial to SMEs, increasing the competitiveness and pushing growth.

13.2.4 Government Incentives

MSMEs form the backbone of our economy and need assistance and protection from other big companies as they lack in resources and technology. To do this the government provides some schemes, rebates or counselling to these enterprises.

Some of the MSME incentive schemes launched by the government are as follows:

- **Udyog Aadhaar memorandum:** Aadhaar card is a 12 digit number given to all individuals by the government. In this, the Aadhaar card is a mandatory requirement. The benefit of registering in this scheme is ease in availing credit, loans, and subsidies from the government. Registration can be done both ways in the online mode or the offline mode.
- **Zero Defect Zero Effect:** In this model, goods that are manufactured for export have to adhere to a certain standard so that they are not rejected or sent back to India. To achieve this the government has launched this scheme. In this, if the goods are exported these are eligible for some rebates and concessions.
- **Quality Management Standards and Quality Technology Tools:** Registering in this scheme will help the micro, small and medium enterprises to understand and implement the quality standards that are required to be maintained along with the new technology. In this scheme, activities are conducted to sensitize the businesses about the new technology available through various seminars, campaigns, activities etc.
- **Grievance Monitoring System:** Registering under this scheme is beneficial in terms of getting the complaints of the business owners addressed. In this, the business owners can check the status of their complaints, open them if they are not satisfied with the outcome.]

- **Incubation:** This scheme helps innovators with the implementation of their new design, ideas or products. Under this from 75% to 80% of the project cost can be financed by the government. This scheme promotes new ideas, designs, products etc.
- **Credit Linked Capital Subsidy Scheme:** Under this scheme, new technology is provided to the business owners to replace their old and obsolete technology. The capital subsidy is given to the business to upgrade and have better means to do their business. These small, micro and medium enterprises can directly approach the banks for these subsidies.
- **Women Entrepreneurship:** This scheme is especially started for women who want to start their own business. The government provides capital, counseling, training and delivery techniques to these women so that they manage their business and expand it.

Check Your Progress

1. How many items are reserved for manufacture by MSME sector?
2. What percentage of MSME advances should go to micro enterprises?
3. How is GST helpful for MSMEs?

13.3 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. Items reserved for manufacture by MSME Sector have been reduced from over 800 to 20.
2. Sixty per cent of MSE advances should go to the micro enterprises.
3. The replacement of multiple taxes by a single, uniform GST not only removes the cascading effect of multiple taxes but also makes it easier to administer and comply with.

13.4 SUMMARY

- An Advisory Committee constituted under the Industries (Development & Regulation) Act, 1951 on de-reservation periodically evaluates products / items reserved for exclusive production by MSME.
- Bank's lending to the Micro and Small enterprises engaged in the manufacture or production of goods specified in the first schedule to the Industries (Development and regulation) Act, 1951 and notified by the Government from time to time is reckoned for priority sector advances.

NOTES

- One of the best and easiest ways of providing assistance to MSMEs is through tax-related benefits.
- Implementation of GST, though considered cumbersome and tedious by most SMEs, will actually benefit them in the longer run. The replacement of multiple taxes by a single, uniform one not only removes the cascading effect of multiple taxes but also makes it easier to administer and comply with.
- MSMEs form the backbone of our economy and need assistance and protection from other big companies as they lack in resources and technology. To do this the government provides some schemes, rebates or counselling to these enterprises.

13.5 KEY WORDS

- **Entrepreneurship:** It means the activity of setting up a business or businesses, taking on financial risks in the hope of profit.
- **Incubation:** In this context, it means services or schemes that help new and startup companies to develop by providing services such as management training or office space.
- **Grievance:** It means a real or imagined cause for complaint, especially unfair treatment.

13.6 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List the items reserved for manufacture by MSME Sector in India.
2. What are the benefits of GST for SMEs?

Long-Answer Questions

1. How does the government provide incentives to the MSME sector though its credit and taxation policies? Discuss.
2. Describe the government reservation and credit policies relating to MSME.

13.7 FURTHER READINGS

Kuchhal, M.C. and Vivek Kuchhal. 2013. *Business Law,* sixth edition. Delhi: Vikas Publishing House.

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UNIT 14 MANAGEMENT OF COMPANIES

NOTES

Structure

14.0 INTRODUCTION

You have already learnt about the Companies Act, 1956 previously. In the final unit of the book, we will examine how companies manage meetings in accordance with the Companies Act. We will examine the types of meetings in companies as well as the prerequisite for holding meetings. The unit will also discuss the sections related to the protection of minority shareholders. The final section of the unit will discuss the methods of winding up companies in detail.

14.1 OBJECTIVES

After going through this unit, you will be able to:

- Define meetings
- Describe the requisites of holding valid meetings
- Explain the various modes of winding up businesses

14.2 MEETINGS: TYPES AND REQUIREMENTS

The word 'meeting' literally means coming together of two or more persons. A meeting is an assembly of people for lawful purpose or the coming together of at least two persons for any lawful purpose [Sharp v. Dawes, (1876) 2 QBD 26 CA]. According to Dr. Sethna, 'A meeting is an association of persons at a particular place and at a particular time for determining a certain specific matter or some

matter which may be put before the meeting.' Thus, a meeting is a gathering or assembly of two or more persons at a pre-decided date, time and place for transacting certain lawful business. However, in certain exceptional cases, even one person can constitute a valid meeting.

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Types

Company meetings may be classified as follows:

I. **Meetings of Members/Shareholders:** (a) Annual general meeting; (b) Extraordinary general meeting; and (iii) Class meetings of shareholders/ members.

II. **Meetings of Directors:** (a) Meeting of the Board of directors; and (b) Meeting of the committees of directors.

III. **Other Meetings:** (a) Meeting of debenture-holders; (b) Meeting of creditors; and (iii) Meeting of contributories.

Requirements of a Meeting

The following are the requisites of a valid meeting:

1. A meeting should be convened by proper authority.
2. It must be convened by a proper notice served in the prescribed manner on all persons entitled to receive such notice.
3. It must be convened to transact lawful business as per its agenda.
4. It must be chaired by properly elected chairperson.
5. It must have a proper quorum.
6. It must be conducted by following lawful procedure.
7. Proper resolutions must be passed for transacting business of the meeting.
8. The minutes of the proceedings must be properly recorded.

Authorities for Convening Meetings

A meeting to be valid must be convened by proper authority. The members' meetings may be convened by the following authorities:

1. **By Board of Directors:** The Board of directors is empowered to convene every type of general meeting of the members of the company. The company's articles generally expressly empower the Board of directors to convene general meetings. Sometimes, the Board of directors is also bound to convene general meetings of members under the directions issued by the Tribunal.

   The Board of directors may, by a resolution, convene general meeting of the members. They may authorize any director or company secretary to

call a company meeting. A general meeting convened by a director or company secretary without authority of the Board of directors, is invalid unless it is ratified by the Board before the meeting is held. [*Hooper v. Kerr, Stuart & Co* (1900) 83 Law Times 729]. It may be noted that a decision to call a valid meeting can be taken only at a validly called and held meeting of Board of directors. A decision made to call an annual general meeting in an invalid meeting of Board of directors shall be invalid and hence the annual general meeting called on the basis of such decision shall also be invalid. [*NVR Nagappa Chettiar v. Madras Race Club* (1949) 1 MLJ 662].

2. **By Directors, on the Requisition of Members:** Sometimes, a requisition is made by the members of the company to call a general meeting. When such a requisition is deposited by the required number of members/ shareholders, the directors should within 21 days, from the receipt of a valid requisition, proceed to call a meeting. Moreover, such a meeting should be held within 45 days of the date of the requisition. If the directors fail to do so, the requisitionists themselves shall be entitled to call a meeting within 3 months of the date of requisition.
3. **The Tribunal:** When the directors make a default in holding annual general meeting (AGM) of the company, the Tribunal may call or direct the calling of such meeting. Similarly, if impracticable for the Board of directors to call and hold a general meeting other than an AGM, the Tribunal is empowered to hold a meeting in any of the following cases: (i) At its own motion; and (ii) On the application of any director or member entitled to vote at the meeting.

Annual General Meeting

Annual general meeting (AGM) is an important meeting of the members of a company. It is an important democratic mechanism for the protection of rights of shareholders of a company. This meeting affords an opportunity every year to the shareholders of the company to review and control the working of the company. AGM is that general meeting of a company which is called and held by specifying in the notice calling it that it is an annual general meeting of the company. It is mandatory for every company other than a One Person Company (OPC) to call and hold a general meeting in each year.

Class Meetings

Sometimes, the share capital of a company is divided into different classes of shares. In such a case, a company may call separate meetings of different classes of shareholders. Such meetings are class meetings. Such meetings are held when it is proposed to vary the rights of a particular class of shareholders.

14.2.1 Protection of Minority Interest

Minority shareholders are the equity holders of a firm who does not enjoy the voting power of the firm by the virtue of his or her below 50% ownership of the firm's equity capital.

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Rights of Minority Shareholders

Many provisions of Companies Act, 2013 deals with the situations where minority shareholders rights have been protected and the same can be divided into various major heads. The rights of minority shareholders are discussed below.

Oppression and Mismanagement

In Companies Act, 1956, the protection for the minority shareholders from oppression and mismanagement have been provided under section 397 (An Application to be made to company law board for relief in cases of oppression) and 398 (An Application to be made to company law board for relief in cases of oppression).

According to Section 397(1) of Companies Act, 1956, the term oppression has been defined as 'when affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members'. Whereas the definition of mismanagement has been defined under Section 398(1) as 'conducting the affairs of the company in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company or there has been a material change in the management and control of the company, and by reason of such change it is likely that affairs of the company will be conducted in a manner prejudicial to public interest or interest of the company'. Therefore, right to apply to the company board for the oppression and mismanagement is provided under the Section 399, which is, meeting 10% of shareholding or hundred members or one-fifth members limit. However, central government under their discretionary powers has allowed any numbers of shareholders to apply for the company board for the relief under Sections 397 and 398. Whereas, on the other hand, under Companies Act, 2013, the relief from the oppression and mismanagement has been provided under Section 241-246 where the relief can be sought from the tribunal in case of mismanagement and oppression through section 244(1) which provides the right to apply to tribunal with the same minority limit mentioned in Companies Act, 1956 but however, the tribunal, while exercising discretionary powers, may allow any numbers of shareholders and to be considered as minority. Further, under the Section 245, Companies Act, 2013, the new concept of class action has been introduced which was non-existent in Companies Act, 1956 wherein it provides for class action suits to be instituted against the company as well as against the auditors of the company.

14.3 METHODS OF WINDING UP

NOTES

Winding up and liquidation are the two terms which are generally used to represent the last stage of the life of a company. It means a process that leads to the dissolution of a company. It is a process whereby the existence of a company is brought to an end by gradually putting an end to the affairs of the company's business. Prof. Gower defines, 'Winding up of a company is a process whereby its life is ended and its property is administered for the benefit of its creditors and members. An administrator, called liquidator is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.' According to A. Ramaiya, 'Winding up is a means by which the dissolution of a company is brought about and its assets realized and applied in payment of its debts and after satisfaction of the debts, the balance, if any, is paid back to the members in proportion to the contribution made by them to the capital of the company.'

Thus, winding up is a process by which the dissolution of a company is brought about. This process is carried out by a liquidator. He is appointed to realize the assets, pay the debts of the company out of the assets so realized and to distribute the surplus if any, among the members of the company. It should be noted that a company is not dissolved as soon as with commencement of winding up of the company. Winding up of a company is the first step towards dissolution of the company. In between winding up and dissolution, the legal existence of the company remains in force. Therefore, it is liable for taxes and other liabilities. Winding up of a company does not imply insolvency of the company. A perfectly solvent company can also be wound up if its members so desire. Moreover, a company cannot be adjudged insolvent under the insolvency laws.

Modes of Winding Up

A company may be wound up in any of the following ways:

I. Winding up by the Tribunal or compulsory winding up.
II. Voluntary winding up.

I. Winding Up By Tribunal/Compulsory Winding Up

A company may be wound up by an order of the Tribunal. This mode of winding up is also known as compulsory winding up of a company.

Grounds for Winding Up

A company may be wound up by the Tribunal on any of the following grounds:

1. If the company is unable to pay its debts.
2. If the company has passed a special resolution for its winding up by the Tribunal. However, the Tribunal is not bound to order of winding up only

because the company has so resolved. The Tribunal shall consider the interest of the company as well as of public before making such an order.

3. If the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.
4. If the Tribunal has ordered the winding up of the company (under Chapter XIX of the Act) because it is a sick company.
5. If an application has been made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal may order for winding up of a company. The Tribunal shall make such an order in any of the following cases:
   (a) If the affairs of the company have been conducted in a fraudulent manner.
   (b) If the company was formed for fraudulent and unlawful purpose.
   (c) If the persons concerned in the formation or management of affairs of the company have been found guilty of fraud, misfeasance or misconduct in connection therewith.
6. If the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years.
7. If the Tribunal is of the opinion that it is just and equitable that the company should be wound up [Sec. 271(1)].

   It may be noted that the power of the Tribunal is discretionary. Hence, it may or may not exercise its powers.

II. Voluntary Winding Up

Earlier, voluntary winding up used to be of two kinds, namely the members' voluntary winding up and creditors' voluntary winding up. But the Companies Act, 2013 provides only for voluntary winding up. Such voluntary winding up may take place only with the consent of both members as well as the creditors. For such winding up, members are required to pass an appropriate resolution. Thereafter, two-third in value of the creditors are also required to give their consent to such resolution. If creditors in such value do not give their consent, the company cannot be wound up voluntarily. Thus, the Companies Act, 2013 has abolished distinction between members' and creditors' voluntary winding up.

Sometimes, two-third in value of creditors passes a resolution that it shall be in the interest of all parties if the company is wound up by the Tribunal. Then the company cannot be wound up voluntarily. In such a case, the company may be wound up only by the Tribunal. Hence, the company shall be bound to file a petition for its winding up by the Tribunal.

Conditions of Voluntary Winding Up

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The following are the conditions with respect to voluntary winding up of a company:

1. **Declaration of Solvency:** Where it is proposed to wind up a company voluntarily, a declaration of solvency shall be made by the directors of the company.

   The declaration has to be made by its director or directors. In case the company has more than two directors, declaration should be made by majority of directors at a meeting of the Board. It should be verified by an affidavit to the effect that they have made a full inquiry into the affairs of the company and having done so, they have formed the opinion that the company has no debts or that it will be able to pay its debts in full from the sale proceeds of assets [Sec. 305(1)].

   The declaration to be effective should fulfil the following conditions:

   (a) It must be made within the 5 weeks immediately preceding the date of passing of the resolution. It must be delivered to the Registrar for registration before that date.

   (b) It must contain a statement that the company is not being wound up to defraud any person or persons.

   (c) It must be accompanied by a copy of the report of the auditors of the company on the profit and loss account of the company and the balance sheet of the company prepared up to the date of declaration.

   (d) It must be accompanied by a report of the valuation of the assets of the company prepared by a registered valuer, if the company has any assets [Sec. 305(2)].

   Sometimes, the company is wound up in pursuance of a resolution passed within a period of 5 weeks after making of the declaration, but its debts are not paid or provided for in full. In such a case, it shall be presumed, until the contrary is shown, that the director or directors did not have reasonable grounds for his or their opinion for such declaration.

   Sometimes, a director of a company makes a declaration of solvency without having reasonable grounds for the opinion that the company shall be able to pay its debts in full. In such a case, he shall be punishable with imprisonment for a term which shall not be less than 3 years but which may extend to 5 years or with fine which shall not be less than '50, 000 but which may extend to '3 lakh or with both [Sec. 305(4)].

2. **Resolution at General Meeting:** After making a statutory declaration by the directors, the company shall pass a resolution for voluntary winding up. Such resolution must be passed within 5 weeks of such declaration.

NOTES

The company is required to pass an ordinary resolution in the following cases:

(i) If the winding up is to take place due to the expiry of the duration of the company fixed by its articles.

(ii) If the winding up is to take place due to the occurrence of any event in respect of which the articles provide that the company would be dissolved.

The company is required to pass a special resolution in any other case [Sec. 304].

3. **Resolution at Creditors' Meeting:** The company shall along with the calling of meeting of the company also call a meeting of its creditors on the same day or on the next day. It shall send a notice of such meeting by registered post to the creditors along with the notice of the meeting of the company called for passing a resolution for its voluntary winding up [Sec. 306(1)]. At such meeting, if two-third in value of creditors of the company are of the opinion that it is in the interest of all parties that the company be wound up voluntarily, then the company shall be wound up voluntarily, otherwise not.

   At such meeting of creditors, the Board of directors of the company shall present the following documents:

   (a) A full statement of the affairs of the company.

   (b) A list of creditors of the company.

   (c) A copy of declaration of solvency.

   (d) A statement of the estimated amount of the claims.

   The Board of directors of the company shall appoint one of the directors to preside at the meeting [Sec. 306(3)].

4. **Delivery of Declaration and Resolutions to Registrar:** The company shall then deliver to the Registrar the declaration of solvency along with the resolution authorizing voluntary winding up. These shall be delivered within 5 weeks of the date of declaration [Sec. 305 (2)]. In addition, the company shall also deliver to the Registrar the resolution passed at the creditors' meeting within 10 days of its passing [Sec. 306 (4)].

5. **Publication of Resolution:** The company shall within 14 days of passing of the resolution give notice of the resolution by advertisement in the Official Gazette and also in a newspaper. The newspaper should be circulating in the district of the registered office or the principal office of the company.

   If a company contravenes this provision, the company and every officer of the company who is in default shall be punishable with fine which may extend to ₹ 5,000 for every day during which such default continues [Sec. 307].

NOTES

Check Your Progress

1. In an organization, how can a meeting be considered valid?
2. What are class meetings?
3. How does Gower define the winding up of a company?

14.4 ANSWERS TO CHECK YOUR PROGRESS QUESTIONS

1. A meeting to be valid must be convened by proper authority.
2. Sometimes, the share capital of a company is divided into different classes of shares. In such a case, a company may call separate meetings of different classes of shareholders. Such meetings are class meetings.
3. Prof. Gower defines, 'Winding up of a company is a process whereby its life is ended and its property is administered for the benefit of its creditors and members. An administrator, called liquidator is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.'

14.5 SUMMARY

- A meeting is a gathering or assembly of two or more persons at a pre-decided date, time and place for transacting certain lawful business.
- A meeting to be valid must be convened by proper authority. The members' meetings may be convened by the following authorities: By Board of Directors, By Directors, on the Requisition of Members, and The Tribunal.
- Annual general meeting (AGM) is an important meeting of the members of a company. It is an important democratic mechanism for the protection of rights of shareholders of a company.
- Sometimes, the share capital of a company is divided into different classes of shares. In such a case, a company may call separate meetings of different classes of shareholders. Such meetings are class meetings.
- Minority shareholders are the equity holders of a firm who does not enjoy the voting power of the firm by the virtue of his or her below 50% ownership of the firm's equity capital.
- Winding up and liquidation are the two terms which are generally used to represent the last stage of the life of a company. It means a process that leads to the dissolution of a company.

NOTES

- It should be noted that a company is not dissolved as soon as with commencement of winding up of the company. Winding up of a company is the first step towards dissolution of the company.
- A company may be wound up in any of the following ways: (i) Winding up by the Tribunal or compulsory winding up; (ii) Voluntary winding up.

14.6 KEY WORDS

- **Annual General Meeting:** It is a yearly meeting of the members or shareholders of a club, company, or other organization, especially for holding elections and reporting on the year's events.
- **Tribunal:** It is a body established to settle certain types of dispute.
- **Liquidation:** Liquidation in finance and economics is the process of bringing a business to an end and distributing its assets to claimants.

14.7 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short-Answer Questions

1. List the different types of meetings in an organization.
2. According to the Companies Act, 2013, what are the rights of minority shareholders?
3. State the requisites of holding valid meetings.

Long-Answer Questions

1. Who are the authorities that can convene meetings? Discuss.
2. Examine the modes of winding up in detail.
3. Explain the conditions of voluntary winding up a company according to the Companies Act, 2013.

14.8 FURTHER READINGS

Kuchhal, M.C. and Vivek Kuchhal. 2013. *Business Law,* sixth edition. Delhi: Vikas Publishing House.

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